The Navigator

Strategy and Asset Allocation Report
4th Quarter 2020

ANCHOR | NAVIGATING CHANGE

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Introduction


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Vicissitude:
Successive, alternating, or changing phases or conditions, as of life or fortune; ups and downs:
They remained friends through the vicissitudes of 40 years.
(Dictionary.com)

Patient investors have been tested during 2020. They have come out ahead through the vicissitudes of the COVID-19 pandemic. The market has been through the lows of March, as we faced the reality of the economic destruction wrought by the lockdowns and general risk aversion to the pandemic. Three months later we spoke about a V-shaped recovery and massive stimulus packages, as central banks around the world became extremely generous to markets in an attempt to buffer the economic contraction. Central bank balance sheets have reached record sizes as global markets celebrated the unprecedented injections of liquidity around the world. We have seen markets reaching record highs in the face of a highly uncertain world, where politics both in the US and South Africa (SA) are likely to set the tone for the next quarter. We have seen markets reaching record highs, at times when the economic activity might only recover to where it was in 2023. We have seen markets reaching record highs at times when unemployment remains elevated both at home and abroad. We have seen markets reaching record highs, as Europe finds itself in the grip of a second wave of COVID-19 infections. Such is the power of central banks and their stimulus measures.

However, not all of this recovery can be attributed to the central banks, though they certainly have lubricated the markets with liquidity. The world was already evolving and many of the trends that were underway have been accelerated. Technology is the way of the future and companies that have used COVID-19 to embrace technology have dominated the brick-and-mortar businesses that have been under lockdown.

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Technology is disrupting how businesses service their clients, the products that clients want, the cost of delivering those products, and the speed of meeting their clients' needs. The age of innovation and technology means that there is a new wave of up-and-coming businesses that will challenge the incumbents. We remain focused on understanding these trends as they develop and on comprehending and analysing the growth prospects of the up-and-coming challengers.

Not all trends that have been accelerated are good. We have been saying for a while that the SA government is running out of money. The lockdown has had a devastating impact on the domestic economy, tax collection, and SA's fiscal position. The challenges that were pre-COVID, perhaps five years away are now upon us. The time for platitudes and kicking the can down the road is over. We have arrived at the point of making the difficult decisions now or facing a choice between the International Monetary Fund (IMF) or a failed state in the near future. It is refreshing to see that the message has been received by government. We are seeing the SABC rightsize its payroll. We have seen a firm stand against borrowing more for South African Airways (SAA), instead insisting that the funds will come from elsewhere. We have seen the first wave of arrests for corruption. We have seen a commitment to cutting the wage bill that has gone to the courts, and the government remains unwavering, even in the face of strike action that is upon them. We have seen a tender for 12,000 MW of renewable energy. We have seen the government finally act on the spectrum auction that has been in limbo for years. We have seen the government abandon plans to nationalise the South African Reserve Bank (SARB). We have seen government state that prescribed assets are no longer being considered as a solution. Overall, we have seen some strong action in an attempt to rebuild our nation. Much remains to be done. SA will only recover if government, labour, and the private sector are able to pull together to form a solution.

We are hopeful for our future but we are also aware of the risks. You will see that we continue to advocate for a balanced investment portfolio, although global equities and domestic bonds remain our asset classes of choice.

Asset Allocation

The following table illustrates our house view on different asset classes. This view is based on our estimate of the risk and return properties of each asset class in question. As individual Anchor portfolios have specific strategies and distinct risk profiles, they may differ from the more generic house view illustrated here.

Asset Class	Benchmark Weight	Current Stance			Expected Returns (local currency) (%)
		Negative	Neutral	Positive	
LOCAL	80%				
Equity	52%		●		11.3
Bonds	16%			●	9.3
Listed Property	6%		●		7.0
Cash	4%	●			3.3
GLOBAL	20%				
Equity	13%		●		5.0
Government Bonds	1%	●			-0.2
Corporate Credit	3%		●		2.0
Listed Property	2%	●			2.0
Cash	1%	●			0.0

Asset Allocation Summary

The range of possible outcomes for the various asset classes is particularly wide at present and it is also highly dependent on your outlook for these different scenarios. We have decided to display the possible outcomes as a series of graphs below. Anchor's base case is somewhere between a scenario of recovering from the pandemic by year-end, or the global economy bumbling along for several years, while this plays out.

There are remarkably few changes since our last document, although we are incrementally more bullish on JSE listed shares. The index level returns might seem quite pedestrian, however, we expect that there might be significant swings in the performance of the shares underlying the index.

In *Figure 1* below, we highlight the US dollar return outlook for the various global asset classes. The bar in *Figure 1*, represents the reasonable range of possible outcomes, with the dots representing our estimate of what the outcome will be in the different scenarios. From a global perspective, equity is the most attractive asset class as long as you do not expect the global economy to plunge into a second recession.

Figure 1: 12M return scenarios for various asset classes in US dollar terms
Source: Anchor

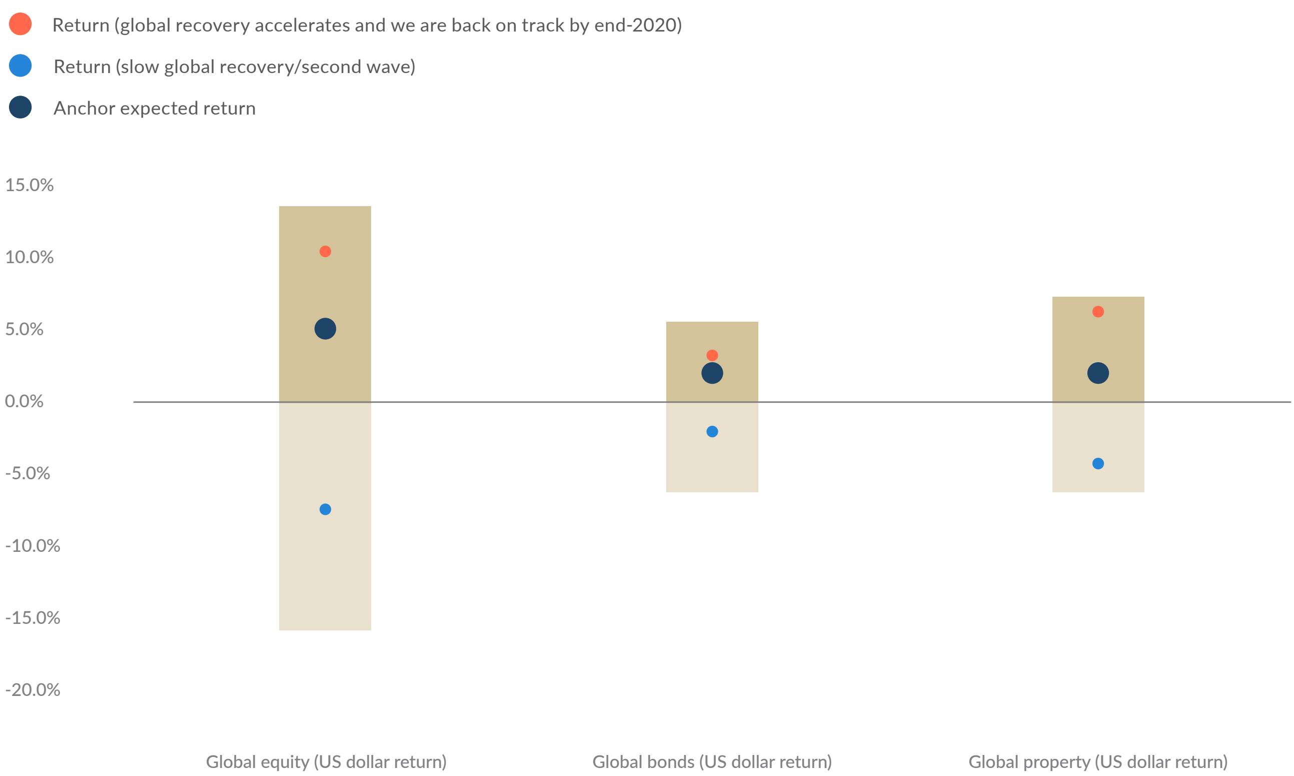


Figure 2: Anchor expected return by offshore asset class
Source: Anchor

	Global equity	Global bonds	Global property
Anchor expected return (in US dollar terms)	5.0%	2.0%	2.0%

In SA, the range of possible outcomes is even wider given that much depends on both the extent of government's structural reform and the behaviour of global risk appetites.

In *Figure 3* below, we highlight the rand return outlook for several asset classes. The bar represents the reasonable range of possible outcomes, with the dots representing our estimate of what the outcome will be under the various scenarios. From a domestic investor perspective bonds are the most attractive asset class on a risk-adjusted basis, but we should also not ignore local equity.

Figure 3: 12M return scenarios for various asset classes in rand
Source: Anchor

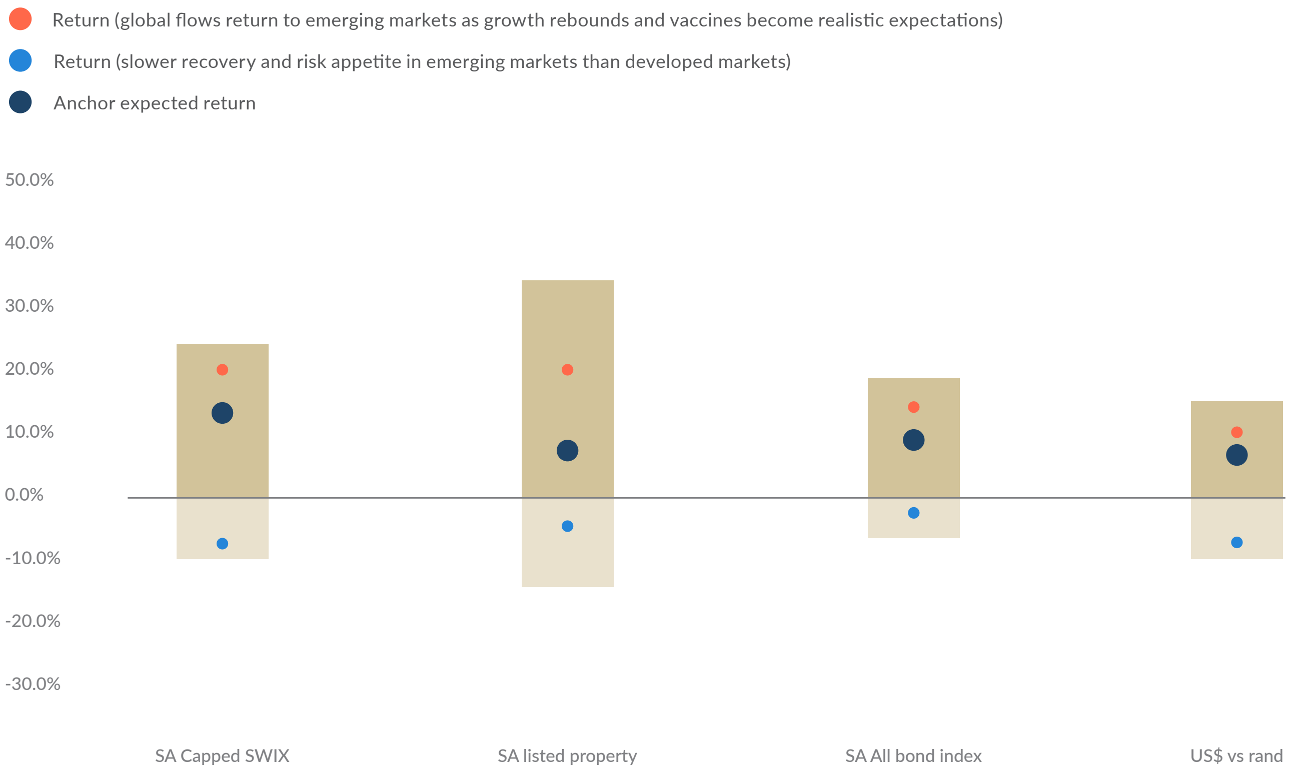


Figure 4: Anchor expected return for domestic asset classes
Source: Anchor

	Domestic equity	Domestic bonds	Domestic property	US$/rand
Anchor expected return (in rand terms)	11.3%	9.30%	7.00%	6.6%

Strategy and Asset Allocation

Moving into the last quarter of 2020, we continue to live with the uncertainty brought about by the global COVID-19 pandemic. Global output collapsed in 1H20 as pandemic took hold, with declines of more than one-fifth in some advanced and emerging market (EM) economies. On the positive side, the prompt and unprecedented level of fiscal and monetary support provided by authorities across the globe assisted in curtailing what would have been a substantially larger contraction. Economic output has since picked up swiftly, following the easing of lockdown measures and the reopening of most businesses. However, the pace of the global recovery has lost some momentum in recent weeks, amid concerns over the rising 'second-wave' of COVID-19 cases across Europe and some US states. Naturally, the renewed virus containment measures in response to these rising cases are fuelling concerns that, after an initial bounce in 3Q20, the pace of a global GDP recovery from the strict 2Q20 lockdowns will be constrained. Consequently, the global economic outlook moving into the last quarter of the year remains clouded and is subject to considerable uncertainty and projections around the trajectory of the COVID-19 virus and policy developments.

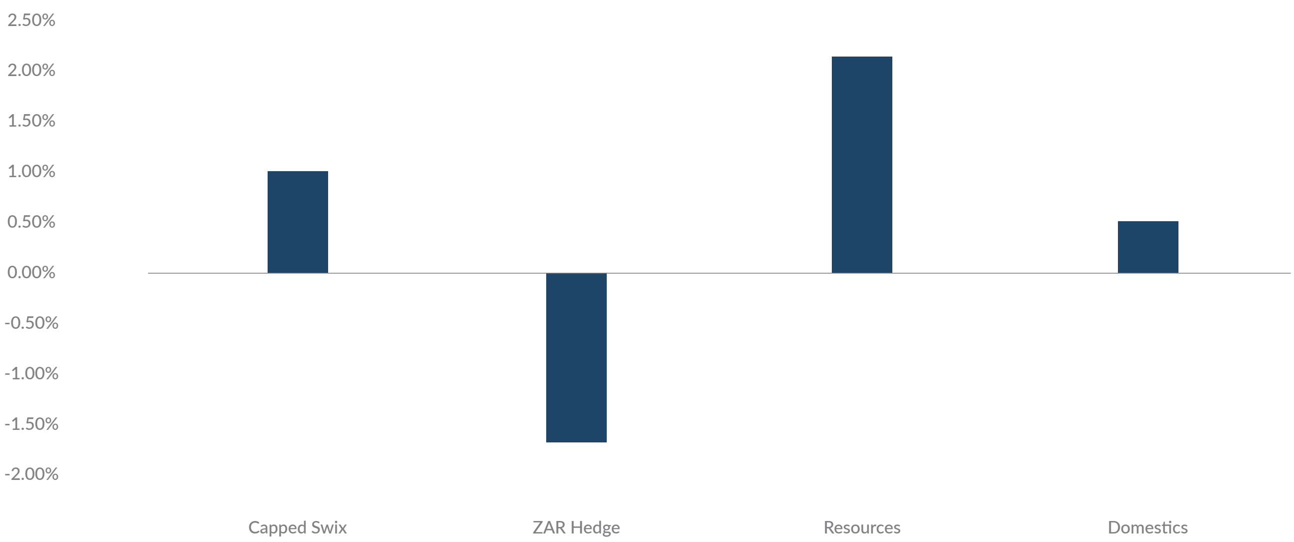
As it stands, global household spending on many durable goods has bounced back relatively quickly, but spending on services, particularly those requiring proximity between workers and consumers, or international travel remains subdued. Whilst working hours have fallen significantly across the globe, government support schemes have helped to maintain household incomes. Nonetheless, corporate investment and international trade remains weak, holding back the pick-up in manufacturing production in many export-orientated economies. Overall, in most economies the level of output at the end of 2021 is projected to remain below its level at the end of 2019, and it will also be considerably weaker than projected prior to the pandemic, highlighting the risk of long-lasting effects from the virus. Going forward, fiscal, monetary, and structural support policies need to be maintained to preserve investor confidence and limit uncertainty but must also evolve with both local and global underlying economic conditions.

On the domestic front, it will be a slow road to recovery for SA. Reported new infections have fallen sharply as we move into 4Q20, with recoveries improving strongly. However, there is still considerable uncertainty about how the pandemic will evolve with the human and economic costs of COVID-19 remaining a problem for some time to come. Whilst we note the positive direction which the ruling party is taking in clamping down on corruption, one cannot disregard the prevailing economic situation in the country - sharply brought into contrast by the recent employment figures which showed that 2.2mn jobs were lost in 2Q20 (representing c. 14% of all jobs at the start of the quarter). Sadly, two out of every three people of working age in SA are now unemployed. Given the inherent uncertainty and the magnitude of the policy challenges created by the COVID-19 crisis, the economic outlook on the domestic front remains clouded. Still, with appropriate reforms to lower the cost of doing business and lift investor confidence, we believe that the potential for medium-term growth both domestically and offshore remains. Nevertheless, much like what was experienced in 3Q20, whilst opportunities continue to exist throughout most asset classes, volatility is likely to remain high for the foreseeable future.

SA EQUITY

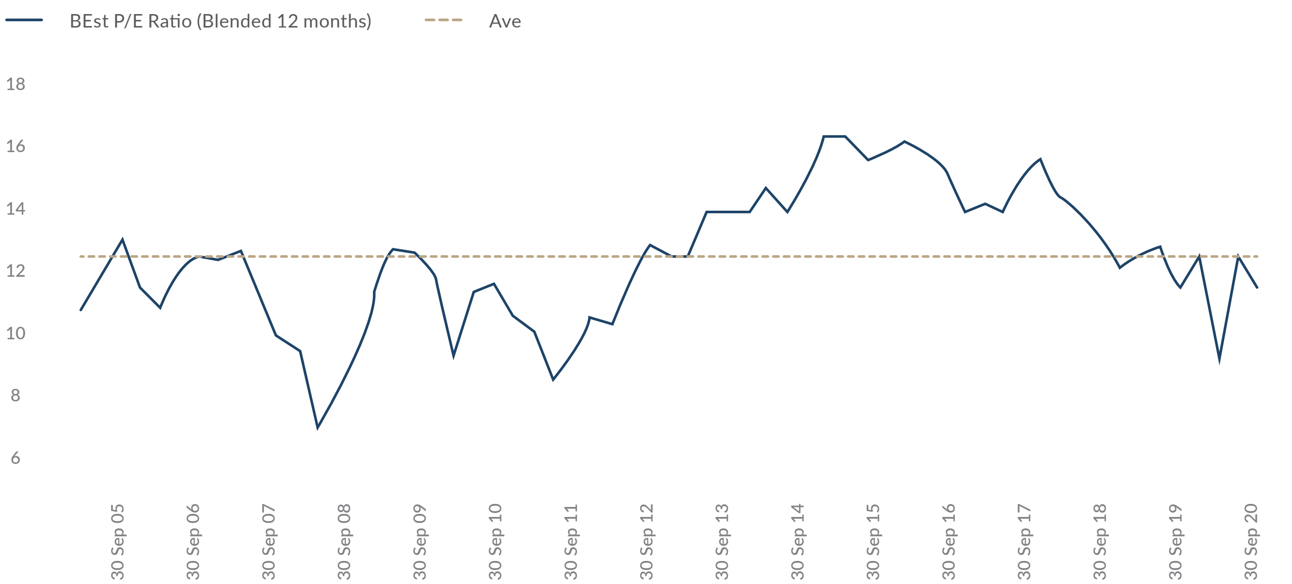
The SA equity market gained 1.02% in 3Q20, managing to avoid a double-digit YTD drop (-9.8%). After the extreme moves experienced by equity investors in 1H20, 3Q20's 1% return appears, on the face of it, quite ordinary. However, as one further interrogates the numbers, the various silos of the market experienced different fortunes with continued volatility and forecast uncertainty resulting in wild swings of sentiment across different sectors of the equity market.

Figure 1: The composition of 3Q20 index returns
Source: Anchor, Bloomberg



At an aggregate level, the JSE is trading slightly below its longer-term average PE multiple of 12.4x, which intuitively does not surprise us especially considering just how much of the local index is now made up of the basic materials sector. This sector tends to trade at lower multiples during periods of margin expansion, such as the conditions we are currently experiencing.

Figure 2: FTSE JSE All Share Index long-term blended and average PE multiples
Source: Anchor, Bloomberg



Those companies reliant on the domestic economy for growth spent most of 2Q20 underperforming the broader index. However, 3Q20 saw a reversal of that trend, as SA gradually emerged from the lockdown and investors were able to assess and quantify just how bad the economic drawdown has been. The return to some semblance of visibility around the operational impact of the pandemic on domestically focussed companies has resulted in what appears to be an operational trough in SA, with a number of catalysts on the horizon to potentially kickstart some incremental positive momentum. We remain underweight the complex, however, as a process we have become incrementally more constructive as business conditions look to normalise and our confidence grows that we are near a trough in terms of company earnings. Unfortunately, we still lack conviction in a more structural domestic earnings recovery (more on this below).

We are confident that plans are in place to ensure a narrowing of the stubbornly high discount to NAV at which Naspers is currently trading and, as such, we remain fully invested in both Naspers and Prosus.

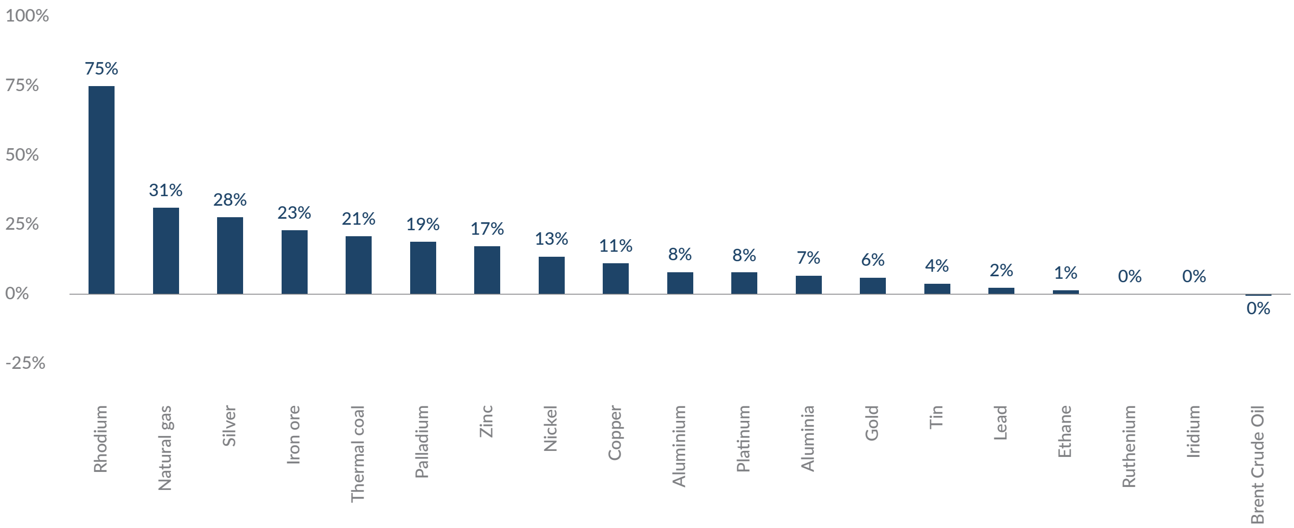
Within the JSE's basic materials sectors, we highlight that the recent strong performance from SA's main export commodities (iron ore, platinum group metals [PGMs], and gold) has seen continuous positive earnings momentum, resulting in the sector accounting for close to 30% of the FTSE/JSE Capped Swix Index - up from around 20% a year ago. As an investment house, Anchor has a clear bias towards higher-quality, less-cyclical businesses, and the 30% weighting in the index makes for some discomfort when considering the volatility of returns we have come to expect from this sector. However, factoring in the optically cheap multiples at which materials companies are currently trading (more in the section on resources below) and demand side factors for those commodities seemingly remaining supportive in the current environment, we have decided that there is enough margin of safety priced in at current levels to warrant our moderate exposure to the sector.

The group of companies with business practices largely outside of SA do not have a particular golden thread that links their fortunes and, as a complex, most experienced a very strong rebound in 2Q20, with the recovery in the rand exchange rate against most global currencies merely holding onto hard currency gains which saw the aggregate contribution to the index return as negative. Large index components such as Naspers ended the third quarter 6% QoQ lower, once again underperforming its underlying investment in Prosus by 2%, and its look-through investment in Tencent by 6%. The reorganisation of Naspers' corporate structure a year ago can now be seen as value destructive for shareholders who have seen the discount widening instead of narrowing. This was despite the key verticals of Naspers/Prosus (outside of Tencent) being well placed to take advantage of the structural shift to living life online, whether it be ecommerce, food delivery or payments, all three of these key verticals have seen an acceleration in consumer adoption, yet have seen the value placed on it by JSE investors impaired significantly. Unfortunately, the Naspers corporate structure will likely remain a drag for shareholders in the short term, although we are confident that plans are in place to ensure a narrowing of the stubbornly high discount to NAV at which Naspers is currently trading and, as such, we remain fully invested in both Naspers and Prosus.

RESOURCES SECTOR

The third quarter was another strong period for the resources sector as the recent momentum in precious metals and iron ore prices continued. The prices of rhodium, silver, iron ore, and palladium ended the quarter 75%, 28%, 23%, and 19% higher QoQ, respectively (see *Figure 3*). Share prices followed suit. The PGMs and gold were the strongest sub-sectors. With the exception of Anglo American Platinum, which had unique volume challenges this year, the major PGM miners such as Northam Platinum, Impala Platinum, and Sibanye-Stillwater were up 47%, 25%, and 23% QoQ, respectively. Similarly, in the gold sector, share prices rose over 20%, except for AngloGold Ashanti. Precious metals miners have substantial operating leverage. These businesses can experience significant changes in earnings expectations from relatively minor changes in the underlying commodity prices. Diversified miners with no exposure to precious metals or iron ore, such as Glencore and South32, continued to show a muted performance in 3Q20. Paper and packaging companies, Sappi, and Mondi, lagged the wider sector as pulp and packaging prices remain muted.

Figure 3: Commodity prices in 3Q20
Source: Bloomberg



We continue to expect that the resources sector will have its strongest earnings growth in the precious metals complex, thanks to the PGM basket price nearly doubling and the gold price jumping 47% YTD in rand terms. For diversified miners, we expect firms with exposure to precious metals and iron ore to grow their earnings faster than those without that exposure. Diversified miners that rely predominantly on base metals are expected to continue having muted earnings growth.

Commodity supply and global growth remain key risk factors for the sector. As COVID-19 lockdowns start to lift around the world, supply for key commodities like iron ore and palladium are expected to begin to normalise. Prices of these commodities have been helped by weaker-than-expected supply, in large part thanks to COVID-19 production shutdowns. In 4Q20, iron ore output out of Brazil may start to normalise as Vale tries to ramp production back up. The local PGM sector will also approach full capacity over the course of 4Q20, following the sharp decline in YTD supply. Disruptions to these supply recoveries would be positive for the sector, in addition to the much-discussed potential V-shaped recovery. Conversely, poor global growth and a strong rebound in supply would be highly bearish.

SA DOMESTIC EQUITY

The road to recovery for the SA economy is going to be long and filled with potential pitfalls. The past decade has seen SA experience a decline in its GDP per capita and rampant corruption has hollowed out business and consumer confidence. Foreign investors have, to a large extent, lost interest in the SA economy and the fiscal position of government is precarious at best. This is a tough position from which to start a recovery journey. However, recently the SA government has started to move in the right directions. Corrupt government officials and businessmen are being arrested, the Independent Communications Authority of SA (ICASA) has finally released the terms for the spectrum auction, and the Minister of Mineral Resources and Energy has gazetted laws that will govern the next round of the 11,813 MW bid window for renewable energy. The lack of urgency from government has been exasperating, but at least the gears are starting to turn and hopefully SA's journey to recovery has begun.

The domestic equity market has largely missed out on the global recovery. From a low of 42% down on 23 March, SA Inc. has recovered but remains approximately 30% lower YTD. The valuation rating of SA Inc. is at all-time lows relative to our EM peers and global markets overall. These low valuation multiples allow us to argue that, although structural earnings growth will remain elusive while the energy crisis in SA is ongoing, some quality domestic companies are offering value.

We continue to view domestic equities as tactical short-term trading opportunities rather than longer-term structural growth stories. But we do believe that there are some interesting opportunities rearing their heads locally and we will look to take advantage of what we consider to be long-term, structural growth stories while also remaining very conscious of the risks associated with SA equities.

With the core of our portfolios having a more longer-term approach, we remain very defensively positioned towards domestically focussed companies. As a complex we remain underweight, however there appears to be many company specific opportunities on which we are building conviction. To mention one, the accommodative monetary conditions (record low interest rates), if matched by a stabilisation of the unemployment crisis could reignite a material pickup in consumer spending, making our retailers well placed for a cyclical rebound.

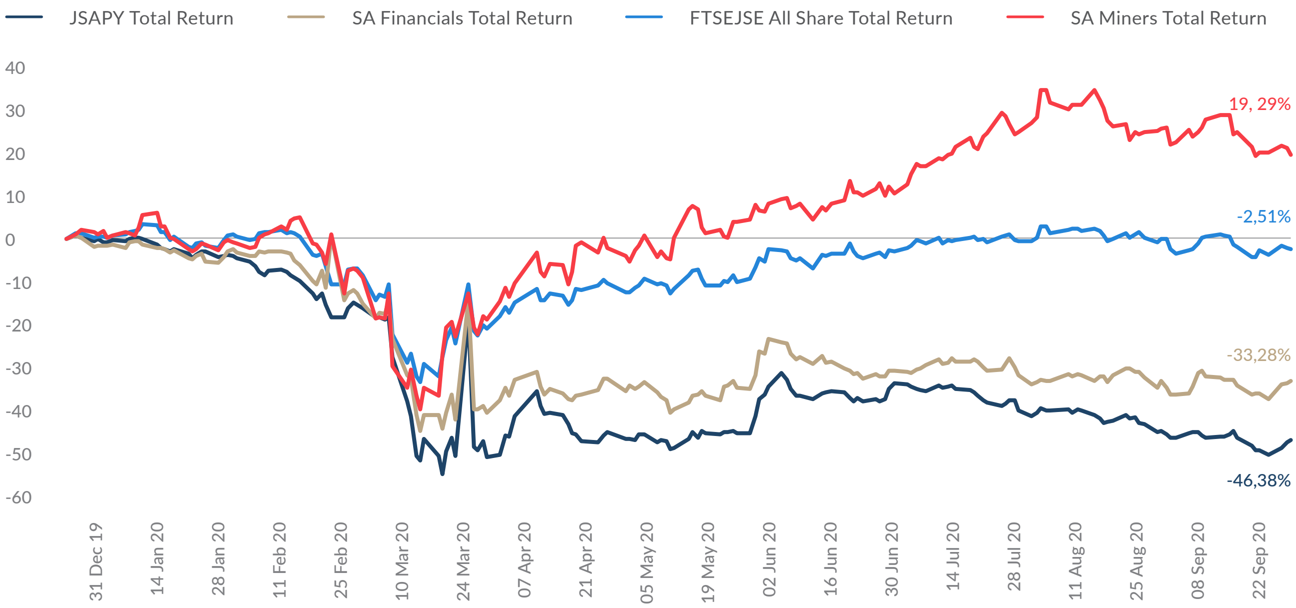
Incorporating all of the above, our twelve-month total return projection for the JSE, using our bottom-up models, is 11.3%. However, we highlight that this bottom-up approach incorporates hundreds of variables, some of which are very difficult to forecast with any degree of certainty. The most important factors that will likely drive returns will be the global monetary and rates environment, and whether SA is able to implement much-needed policy reform and win the benefit of the doubt from foreign investors once again.

SA PROPERTY

The SA listed property sector has continued to underperform the overall local market and has emerged as the asset class hardest hit by the COVID-19 pandemic.

The SA Listed Property Index (JSAPY) fell by 3% MoM in September, by 14% in 3Q20, and is down 46.4% YTD. *Figure 4* below shows the YTD performance of the JSAPY vs major SA equity indices including the FTSE JSE All Share Index.

Figure 4: JSAPY - the worst performing sector on the JSE in 2020
Source: Anchor, Refinitiv



The local property sector is now in unchartered territory as real asset valuations (shopping centres, offices, industrial sites etc.) fall and the incomes being generated by these assets decline as consumers shop online and people work from home. The pandemic has, virtually overnight, changed the nature of the relationship between landlord and tenant from a contractual one to a commercial one that requires an understanding of, and a reaction to, client conditions. As these factors deteriorate to this point due to the countrywide and global lockdowns, the painful impact on property owners must be shared with tenants to avoid systemic carnage across most sectors of the economy.

For equity property investors this has two main focal points, i) dividends and share prices that reflect this income stream as well as ii) valuations attributed to the physical assets.

DIVIDENDS

Most of SA's listed property companies are real estate investment trusts (REITs). REITs are effectively allowed to operate on a tax-neutral basis, which means that distributable earnings are not subject to tax at the company level and flow straight through to the investor, who then pays income tax on the amount paid out. This applies if at least 75% of distributable earnings are paid out on this basis - a requirement for a company to retain its REIT status. Severe constraints on rental collections, caused by the pandemic, has meant that net property income (NPI) has fallen. Management therefore needs to allocate lower earnings to various stakeholders, including servicing debt funders.

It was recently reported that the JSE, which governs listing requirements, may have given a special dispensation to REITs to not pay dividends for a period of time in order to retain earnings, pay-down debt, and strengthen their balance sheets during this difficult period. However, this is not the case, instead what has been agreed upon is a six-month window post financial year-end for REITs to pay their regulated amount of distributable earnings – effectively a two-month extension on the normal rules.

VALUATIONS

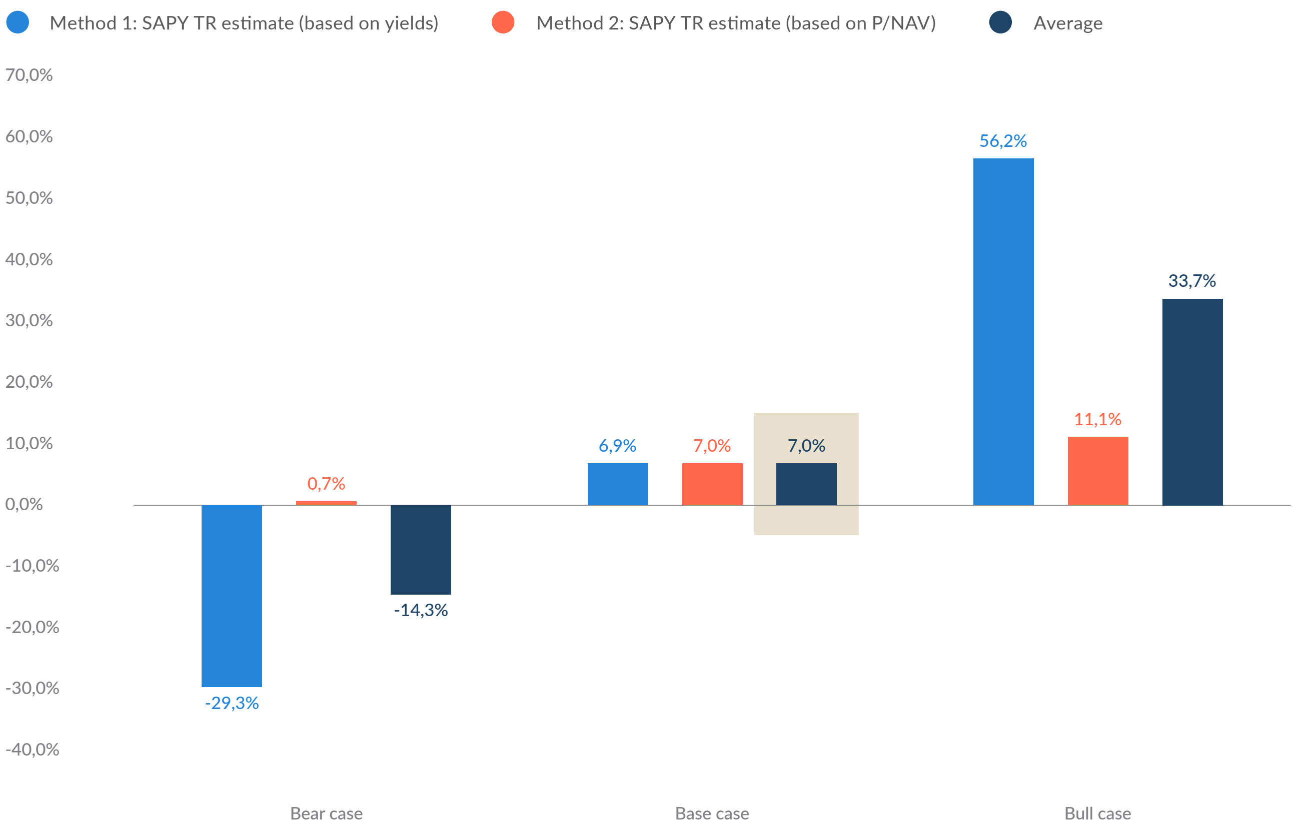
Whilst the JSE ruling may seems beneficial for investors at first glance, it does shine a spotlight on those REITs with high loan-to-value (LTV) ratios. Because physical property assets are not liquid, sales to pay-down debt take time. When there is some distress in markets, this time lag is exacerbated. Listed shares have therefore come down to price levels which appear great value based on published net asset values (NAVs). However, in reality, this is the anticipation in advance of property values falling, owing to earnings declines and the lag in valuators reacting to these circumstances.

Long-term investors can take comfort in the fact that fundamentals will return to the sector, and these will govern the returns produced. Still, the current environment makes forecasts difficult and also means that there are a wide range of outcomes possible, due to the following:

- Payout ratios will differ from company to company (and some may not pay out dividends, either giving up their REIT status or citing liquidity constraints).
- The revenue model of some property segments may change (i.e. retail rentals may move towards a more turnover-based formulae).
- Valuations may be under pressure for some time due to the lag effect.

Our bull-, base- and bear-case 12M returns in the sector, using a methodology of equally weighting returns, based on (1) forecast yields; and (2) price/NAVs is presented below.

Figure 5: Anchor 12-month property sector return scenarios
Source: Anchor



Our base-case, 12-month return forecast is currently 7%, with the caveat being that the sector will remain extremely volatile.

SA BONDS

2020 has proven to be a dramatic year, with all asset classes impacted by the spread of the COVID-19 pandemic. Local fixed-income investments have been no different. In the previous edition of *The Navigator – Anchor's Strategy and Asset Allocation, 3Q20*, the impact of the pandemic was still in its infancy. We now have reliable indicators that show the extent of the economic damage (for example the large increase in SA unemployment as over 2.2mn job seekers exited the market), as well as some evidence around the SA government's monetary response to the virus. The fiscal impacts thereof will become clearer in the coming months – with the medium-term budget policy statement (MTBPS) to be presented by Finance Minister Tito Mboweni at the end of October.

SA bonds sold of dramatically in March and into April. However, 3Q20 proved to be far more muted. Bonds remained range-bound, with the R186 trading at between 7.13% and 7.91% for the quarter. Currently, the R186 trades at 7.2% and the R2030 at 9.4%. The domestic bond curve remains steep, with a large increase in yield pickup for term between the 5-year point and the 20-year point (the spread between the R2040, maturing in 2040, and the R186, maturing in 2026, is currently at 4.5%).

This bifurcation is being driven by two issues:

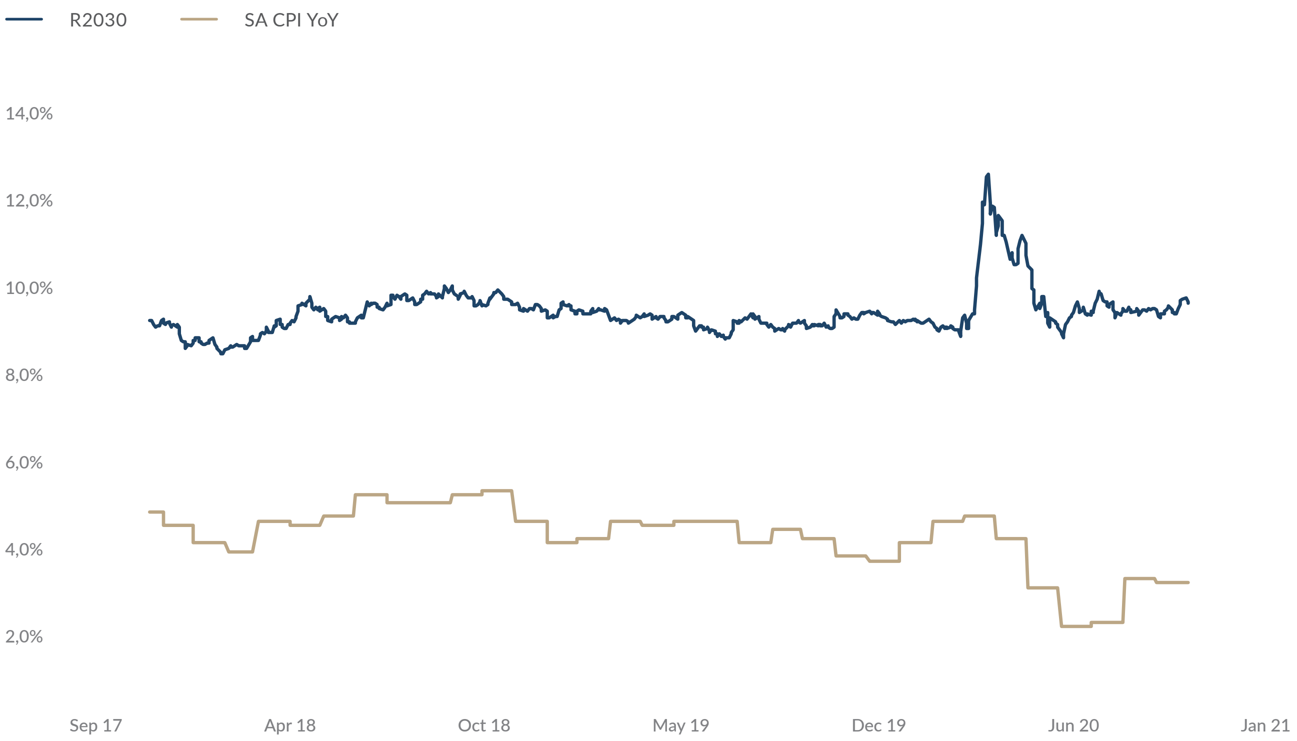
1. Rate cuts from the SA Reserve Bank (SARB) driving the short end of the curve down.
2. A lack of confidence in SA's longer-term fiscal outlook.

Since January 2020, the repo rate has come down from 6.5% to 3.5%, this rate cutting cycle has aggressively brought the short end of the curve down. Added to this, SA's fiscal position is now weaker than it has been in decades. With debt to GDP projected to reach over 80% by the end of 2020.

Anchor's position remains cautiously optimistic - duration assets remain attractive both from a yield and a capital appreciation perspective, particularly considering the repo rate cuts. With inflation expected to remain subdued for the next 2-3 years, a yield of over 9% (on offer from R2030s at present) will equate to a real return of 5%-6% p.a. over the next 2-3 years.

Below, we present this outlook graphically – mapping SA inflation (a monthly printed figure) vs the yield on offer from the R2030 bond (using daily close mid quotes).

Figure 6: R2030 yield vs SA YoY CPI
Source: Anchor, Bloomberg



As can be seen in *Figure 6*, the R2030 presents as a highly attractive investment in a low-inflation environment at current yields.

The major risk factor and opportunity factor to the above remains the same – the domestic political outlook shifting dramatically one way or the other. The current milieu appears to be turning sharply against corrupt factions within the ruling ANC, investigations are bringing to light the depths of the graft, and prosecutions seem inevitable. However, a meaningful SA recovery is likely to be slow and fraught with risk. We expect that bonds yields will trade largely sideways but remain volatile. This gives us an expected return of 9.3% from bonds for the next year.

RAND

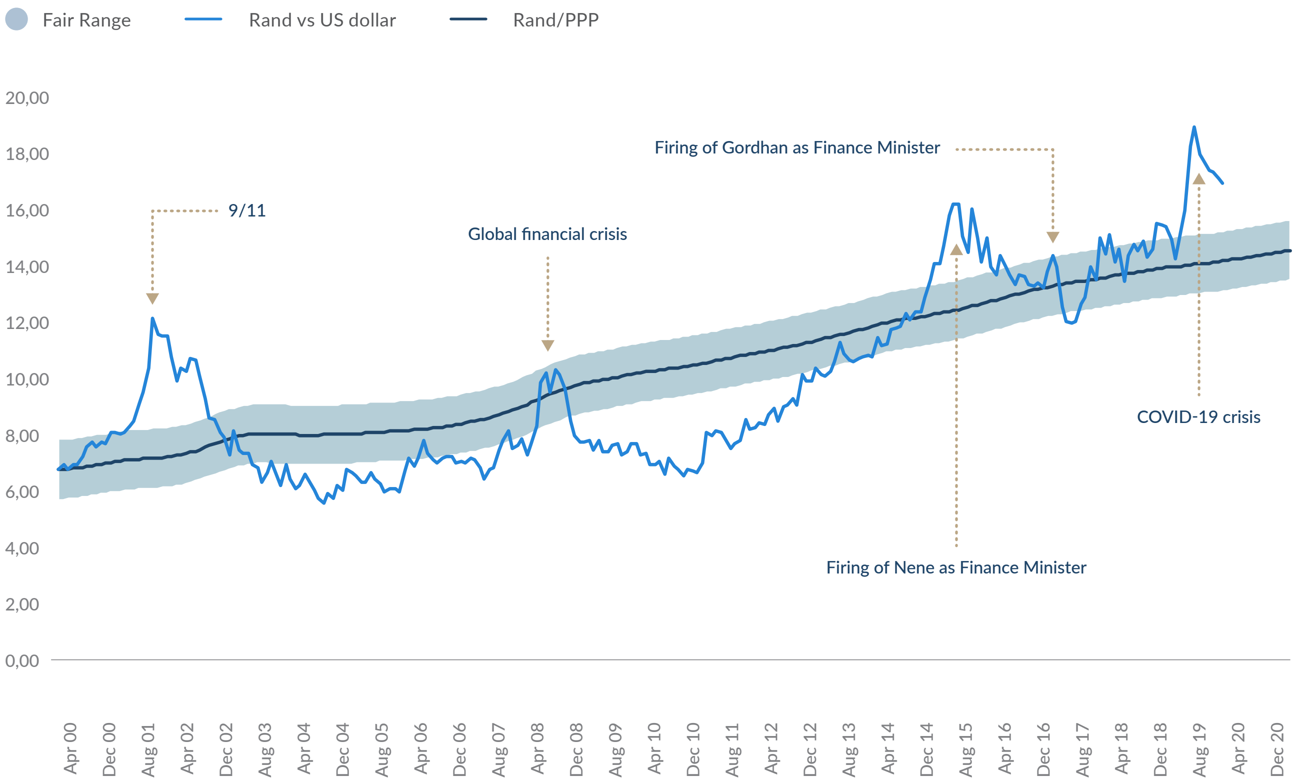
Projecting the rand's value in a year's time is a fool's errand. The rand vs US dollar exchange rate is one of the world's most volatile currency pairs and trades well away from any modelled fair value for long periods. We note, however, that the rand trades within a R2.50 range to the dollar in most 12-month periods and after the rand's extreme weakness in March, the local currency has been clawing back some of those losses.

We maintain our view that, while the rand should trade on the weaker side of fair, it is oversold at current levels and therefore, as the world recovers from this crisis, we see scope for the rand to recover more of its losses. Nevertheless, we also think that this will be a slow process and that, for now, the rand will remain range bound in a volatile environment with a slight strengthening trend over time. As with all asset classes, the near-term outlook for the COVID-19 crisis also dictates the near-term outlook for the rand.

We retain our purchasing power parity (PPP) based model for estimating the fair value of the rand and we have extended this out by three months since the publication of *The Navigator – Anchor's Strategy and Asset Allocation, 3Q20* report on 14 July 2020. Our PPP-modelled value for the rand vs US dollar at the end of the next 12 months is R14.20/$1 (See *Figure 7*). We apply a R2.00 range around this to get to a fair value range of between R13.20/$1 and R15.20/$1.

We expect the rand to remain particularly volatile and on the weaker side of our fair range band. This would imply that we see scope for up to a 6.6% improvement from the rand's current levels as the world recovers.

Figure 7: Actual rand/US dollar exchange rate vs rand PPP model
Source: Thomson Reuters, Anchor



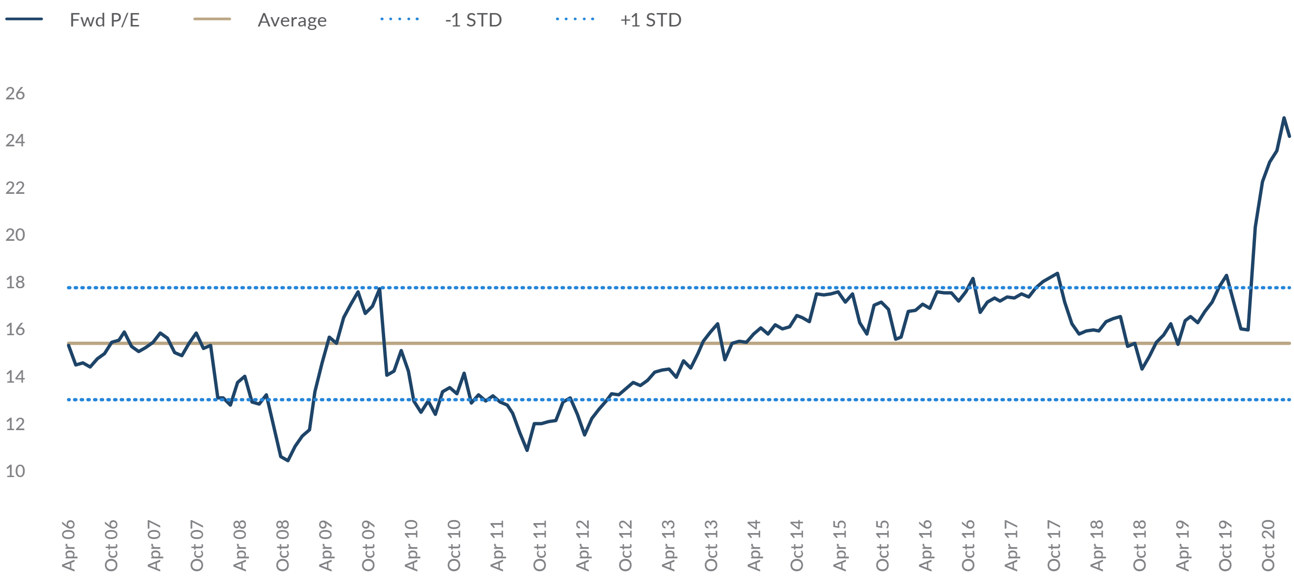
GLOBAL EQUITY

Following three quarters of the 2020 equity market roller coaster, the MSCI World Index is up 2.1% YTD in US dollar terms – an outcome few would have predicted in the depths of the March 2020 market crash. Unprecedented global stimulus came to the rescue (largely in developed markets) and, thus far, investors have been prepared to look through the COVID-induced economic slump.

In 3Q20, the MSCI World posted a US dollar total return of 8.0%, while the MSCI Emerging Markets Index recorded a 9.7% gain over the quarter. In September, global markets finally wobbled after a five-month winning streak as most major equity benchmarks lost ground. The tech-heavy Nasdaq 100 Index fell by over 10% in three days in early September but recovered somewhat to end the month 5.7% lower. Despite its September wobble, the Nasdaq is still up 31.6% YTD - well ahead of the S&P 500 (5.6% YTD) and Japan's Nikkei 225 (+2.8% YTD in US dollar terms), which are the only other two major equity markets in positive territory for 2020. There was no clear catalyst for the September declines, although the continued inability of US Congress to agree to new fiscal stimulus measures and a new wave of COVID-19 infections in Europe likely contributed.

With markets flat and earnings slumping, the MSCI World forward PE has risen to expensive levels, although a predicted earnings recovery will reduce the valuation in the ensuing two years.

Figure 8: MSCI World fwd PE
Source: Anchor, Bloomberg



This is reflected in *Figure 9* below, which indicates that consensus earnings forecasts show a 45% recovery in the next 12 months, reducing valuations back to slightly ahead of historic averages.

Figure 9: MSCI and S&P 500 consensus earnings forecasts and forward PEs one-and two-years out
Source: Anchor, Bloomberg

Name	Earnings Growth		FWD P/E		
	YR1	YR2	Current	YR1	YR2
MSCI World Index	44.6%	11.6%	23.8	16.5	14.8
MSCI EM Index	60.8%	-1.8%	17.6	11.0	11.2
MSCI All Country World Index (10% EM)	46.7%	9.0%	22.8	15.6	14.3
S&P 500 Index	30.3%	13.8%	25.2	19.3	17.0

Global markets should be broadly viewed in two segments:

- The future of technology companies (now accounting for over 35% of US equity markets) accelerated in 2020 as the global consumer shifted their expenditure online. There have been some phenomenal performances from tech shares this year and this segment of the market is probably due for a breather. We find the asset-light compounding nature of these businesses very attractive and essential in a long-term investment portfolio. Stock-picking has become increasingly important in an environment of elevated valuations. We think most of the winners for the next decade are in this sector.
- Industrial and financial services shares are generally still well below their January 2020 highs and there are attractive opportunities in this space as the world returns to normal. Our focus is on businesses that have sound balance sheets and will revert to 2019 earnings in 2021/2022.

The COVID-19 pandemic continues to occupy the minds of investors, but it should be borne in mind that it is not the pandemic itself that matters, but rather the fear of the virus and government and consumer reaction to this. We think fear is subsiding, but the reality of higher unemployment and lower benefits will influence the future. An effective vaccine will be good for markets.

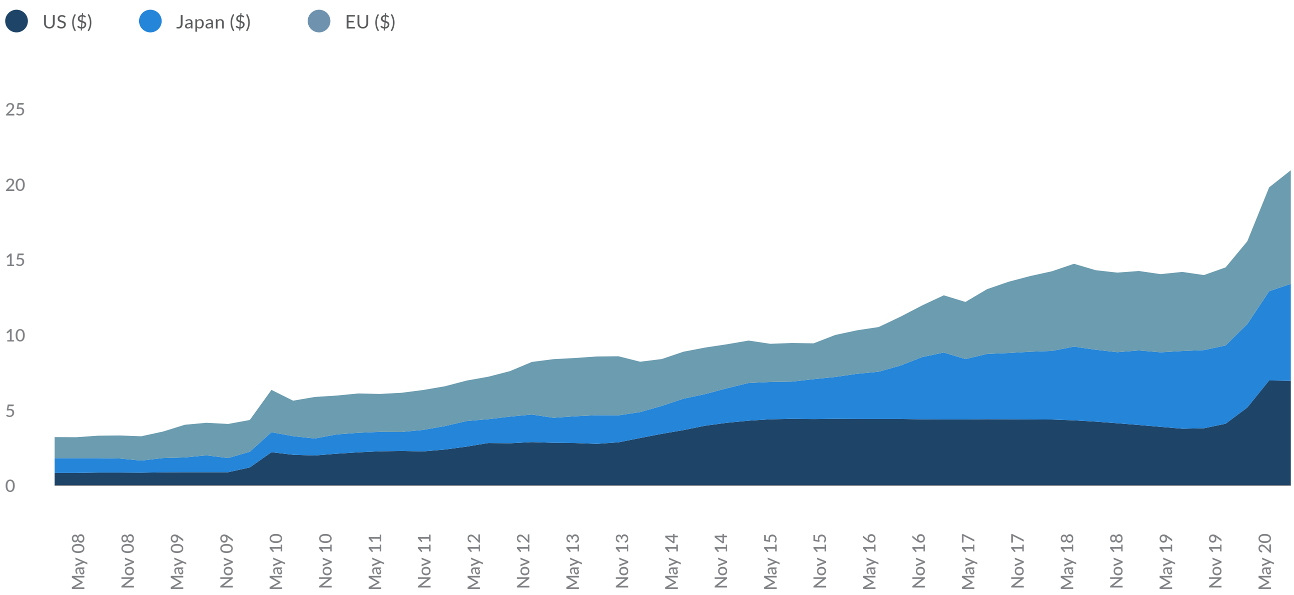
The US Presidential Election scheduled for 3 November, will dominate headlines in the current quarter. Polls are pointing to a Joe Biden victory, which will result in a large fiscal stimulus and should be positive for global equities.

While global equity index levels are close to flat, the performance of different sectors has been marked. On an aggregate basis, we project a 5% return from global equities in the next 12 months, with valuations starting at fairly full levels. The bulls argue for higher valuations, as the cost of money is lower (probably for an extended period) and alternatives are limited. However, within the global equity market we think there are significant opportunities.

GLOBAL BONDS

The US Fed's gargantuan effort to ensure that liquidity did not dry up during the COVID-19 market collapse, saw it almost double the size of its balance sheet from \$4.2trn in February to \$7.2trn in May. It was not alone in its effort to flood global markets with liquidity and the \$3trn liquidity injection from the US Fed was supplemented by about \$2.4trn from the ECB (whose balance sheet is even larger than that of the Fed at \$7.7trn) and \$1.2trn from the Bank of Japan, which went into March 2020 with the largest balance sheet (\$5.2trn), but emerged slightly behind the US and the EU with a balance sheet of \$6.5trn.

Figure 10: Quantitative easing - major global central banks flooded the market with \$6.5trn of liquidity since March 2020
Source: Anchor, Bloomberg



The Fed expanded beyond its traditional quantitative easing (QE) method (buying government bonds), to injecting dollars directly into the corporate bond, municipal debt, and commercial paper markets. It has also been providing loans directly to companies and supplied almost $0.5trn directly to foreign central banks. Interestingly, most of the liquidity injected into these peripheral QE programmes (which totalled about $0.8trn over March and April) has now essentially been repaid with corporate bond markets and foreign central banks no longer requiring the additional liquidity. So, despite continuing to purchase about $80bn of government bonds each month, the Fed has not grown its balance sheet over the last few months.

The fact that these additional sources of liquidity are no longer required by corporates and foreign central banks is fairly encouraging as an indicator of economic stress in those markets. It is also comforting for high-grade, corporate bond investors to know that liquidity risk, which was becoming a major concern as a result of post-global financial crisis (GFC) regulations, which effectively prevented commercial banks from acting as the buyer of last resort, has been fixed by the willingness of major central banks to step into that role in size. This gives us relatively more confidence in estimating the path of US investment grade corporate bond spreads, which we think could potentially contract to around 1.2% over the next twelve months.

We expect US core inflation to edge marginally higher over the course of the next twelve months, from the current level of 1.5% to around 1.7%. We still believe the major influence on US 10-year government bond yields will be from demand (QE) over the forecast horizon, with only a modest term premium. Any return to a more fundamentally based valuation, where investors expect a reasonable real return from US government debt, will probably be a fairly long way off. As such, we expect US 10-year government bond rates to reach only 0.8% twelve months out. This leaves us with a total return forecast for US 10-year government bonds of -0.2% over the next twelve months and a total return on US investment grade corporate bonds of c. 2.0% over the same time horizon.

GLOBAL PROPERTY

In 3Q20, we saw a continuation of the previous quarter's (2Q20) theme – strong returns from online-related sectors such as data centres and warehouses and the continued poor performance from old brick-and-mortar sectors such as retail, office, and residential. Particularly noteworthy during the quarter was the announcement by Unibail-Rodamco-Westfield (URW), one of the largest global retail REITs, that it planned an equity raise to shore up its balance sheet. This announcement saw URW's share price drop by 20%, increasing its discount to NAV from c. 80% to c. 85%. A 2018 transaction in which Unibail-Rodamco merged with Westfield in a 40% debt-funded deal saw URW's loan-to-value (LTV) ratio jump to 37% (close to its 40% internal threshold). That LTV ratio has now crept up to around 41.5% (although it remains comfortably below the 60% covenant levels). URW will ask shareholders to vote on the EUR3.5bn capital raise in early November. If successful, shareholders will need to stump up EUR25.2/share on a counter whose share price is currently trading at around EUR31. In addition to the equity raise, URW is looking to sell EUR4bn of assets (primarily Paris offices [offices currently account for less than 10% of its portfolio]), in an attempt to get its LTV ratio down to around 30% and maintain its investment-grade credit rating (and, in turn, its continued access to cheap funding).

The market reaction to URW's capital raise is also an indication of investor appetite for the sector and skepticism around the future value of retail assets globally. This is a sector where US retail heavyweight, Simon Property Group (SPG), is suing its largest, non-anchor tenant, the retailer Gap, which accounts for c. 3.5% of SPG's total rentals, for non-payment of rent during the COVID-19 related store closures. So, clearly it is a sector in deep turmoil.

During the GFC, US retail vacancies increased for six consecutive quarters from <6% to over 9% and took twice as long (three years) to get back to below the 6% vacancy level. And that was in an environment where online shopping was less of a threat than it is today! So, it's unlikely that vacancies have troughed and very likely that the path back to decent occupancies will be a slow one. The big question is whether the huge discounts to NAVs already reflect that eventuality.

Office REITs, particularly those in major urban areas, are significantly less exposed to the hardest hit sectors (retail and hospitality), being vulnerable predominantly to the more resilient tech, media, and finance sectors. Questions around how long the work-from-home (WFH) trend will continue and whether it is a temporary or structural shift remain. Rental collections and vacancies have held up relatively well, but valuations in the sector reflect a belief that WFH trends are probably structural with quality US office REITs such as Boston Properties trading on a forward dividend yield that is about 4% ahead of US 10-year government bond yields (which is around the peak levels it reached during the GFC, when its tenants were in the eye of the storm).

Questions around how long the work-from-home (WFH) trend will continue and whether it is a temporary or structural shift remain.

On the opposite end of the spectrum, delays in additional supply in the warehouse and data centre space, as new construction is hampered by the pandemic, are driving solid rental growth there. However, we expect this supply shortage to be more cyclical in nature and, as such, current yields of around 3%–4% with less scope for development driven growth seem fairly full. All told, we think the 4% estimated forward dividend yield at the sectoral level is likely to be partially offset by a slight derating in some of the highly-rated sectors' growth prospects and a further deterioration in retail sector income will leave investors with a total return of around 2% over the next twelve months.

ANCHOR INSIGHTS

In this section, staff from across Anchor provide insights into our thinking, strategy, and view of the world. This quarter, Peter Little follows the 2020 US elections and talks about how it could play out; Seleho Tsatsi explores Apple and *Fortnite* developer Epic Games' battle for control of app store fees; Glen Baker discusses how to invest for dividend income; Nichole Maroun examines the option of South Africans looking offshore for great investment opportunities and, finally, Di Haiden explains offshore trusts.

US election 2020:

Four more years or a blue sweep and the implications for markets

Written By:

Peter Little
Fund Management

EXECUTIVE SUMMARY

- Incumbent, Donald Trump, will run for a second term, hoping to avoid becoming only the fifth US president in the past 100 years to miss out on a second term.
- Polls currently suggest a victory for Democratic challenger, Joe Biden, though the outcome is likely to hinge on a few key "swing states" which are probably too close to call at this stage.
- Democrats are likely to maintain control of the House of Representatives, but the key question is whether they can also wrest control of the Senate and the presidency from Republicans.
- A "blue sweep", where Democrats take control of the Presidency, the Senate, and the House would see the most significant shift in policy, including an increase in government spending and higher corporate taxes.
- The US economy is likely to benefit from a strong Democratic showing, with the increase in government spending likely to outweigh the drag from higher taxes in the short- to medium-term.
- The COVID-19 pandemic has increased the appeal of mail-in voting, which could result in a higher voter turnout which is most likely to benefit the Democrats. Mail-in voting is regulated at a state level and is currently subject to multiple legal challenges from both sides which is expected to cause a delay in the confirmation of the election result.
- The last time election results were disputed/delayed in 2000, markets fell around 8% in the weeks of uncertainty between the vote and the final outcome. Markets are already largely anticipating this with costs for hedging against equity market corrections around the election already extremely elevated.
- The other issue most likely to impact markets could come from a partial reversal of Trump's US corporate tax cuts (which drove a c. 20% re-rating in US equity markets in early 2019).

IMPORTANT DATES

The second presidential debate:
Thursday, 15 October 2020.

The third presidential debate:
Thursday, 22 October 2020.

Voting day:
Tuesday, 3 November 2020.

Election results could be finalised by around 8am SA time on 4 November 2020 although, **with a large contingent of mail-in votes, it is extremely likely that the final result will be delayed by days, or even weeks, if there are legal challenges.**

US POLITICS 101

1. THE PRESIDENT

A US president is elected every 4 years and can serve a maximum of 2 consecutive terms, so the incumbent **Republican president (Trump) is eligible for another term and will face off against his Democratic challenger Joe Biden.**

Each US state gets a set number of electoral votes to allocate to the presidential candidate who gets the most votes in that state. The states allocate their electoral votes on a winner-take-all basis (except Nebraska and Maine, who pro rate them). **There are 538 available electoral votes and a candidate needs at least 270 of these votes to be elected president.**

Electoral votes are not proportionate to the population, e.g. Wyoming has a population of c. 0.6mn people and 3 electoral votes compared to California with c. 40mn people and 55 electoral votes – so c. 70x more people but only c. 18x more electoral votes. **This makes Wyoming votes theoretically almost four times as valuable as California votes. So, it is possible to become president while winning less votes than the challenger** and in fact that has happened twice in the last 20 elections. In 2000, George W. Bush Jnr. won the election with 0.5% less votes than Al Gore and in the 2016 election Trump won with 2.1% less votes than Hilary Clinton.

Figure 1: Presidential election results and the corresponding % of the popular vote in the past 20 US elections
Source: Anchor

● Democrat Victory ● Republican Victory

Year	Republican Candidate	% Popular Vote	Democratic Candidate	% Popular Vote
2016	D Trump	46,1%*	H Clinton	48,2%
2012	Mitt Romney	47,2%	B Obama	51,1%
2008	John McCain	45,7%	B Obama	52,9%
2004	GW Bush	50,7%	J Kerry	48,3%
2000	GW Bush	47,9%*	A Gore	48,4%
1996	B Dole	40,7%	W Clinton	49,2%
1992	GHW Bush Snr	37,4%	W Clinton	43,0%
1988	GHW Bush Snr	53,4%	M Dukakis	45,6%
1984	R Reagan	58,8%	W Mondale	40,6%
1980	R Reagan	50,7%	J Carter	41,0%
1976	G Ford	48,0%	J Carter	50,1%
1972	R Nixon	60,7%	G McGovern	37,5%
1968	R Nixon	43,4%	H Humphrey	42,7%
1964	B Goldwater	38,5%	LB Johnson	61,1%
1960	R Nixon	49,6%	JF Kennedy	49,7%
1956	DD Esenhower	57,4%	A Stevenson	42,0%
1952	DD Esenhower	55,2%	A Stevenson	44,3%
1948	T Dewey	45,1%	H Truman	49,6%
1944	T Dewey	45,9%	F Roosevelt	53,4%
1940	W Willkie	44,8%	F Roosevelt	54,7%

*Won the presidency despite lower share of the popular vote.

2. CONGRESS

The US Congress is made up of two chambers - the Senate, and the House. **They have power over the budget (taxation and government spending) and creating laws.**

a) **Senate:** 100 seats – each of the 50 states have two senators who serve a six-year term (votes are staggered so roughly one-third of senators are elected every two years).

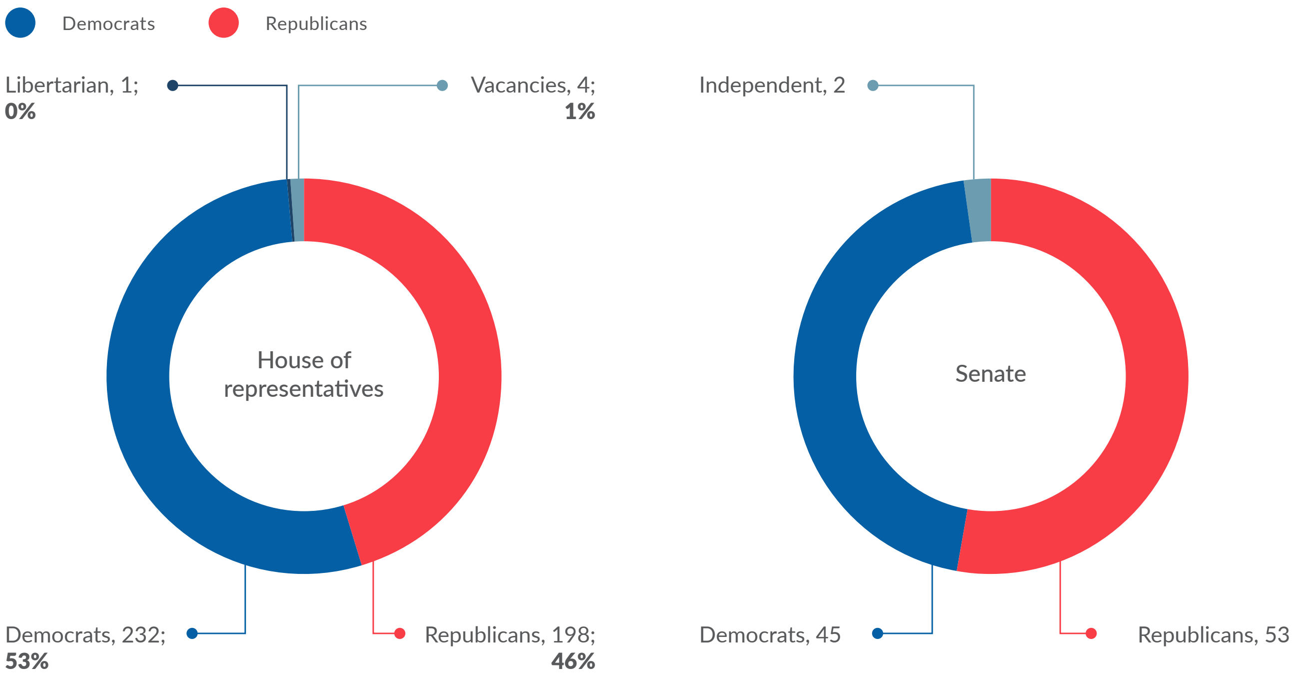
b) **House of Representatives:** 435 seats with each state getting allocated seats roughly in proportion to their population (with a minimum of 1 seat per state). Representatives serve two-year terms.

New laws, as well as spending and taxation proposals, generally pass through the House for approval and then the Senate (where 60% approval is usually required) before being signed into law by the president, who can veto these proposals. Spending and taxation bills can avoid the 60% majority in the Senate with a process called reconciliation.

The current state of play

Congress is currently split, with the Democrats controlling the House and the Republicans controlling the Senate. That makes it challenging to get budgets and new legislation approved.

Figure 2: Current representation in the US Congress
Source: Anchor Capital



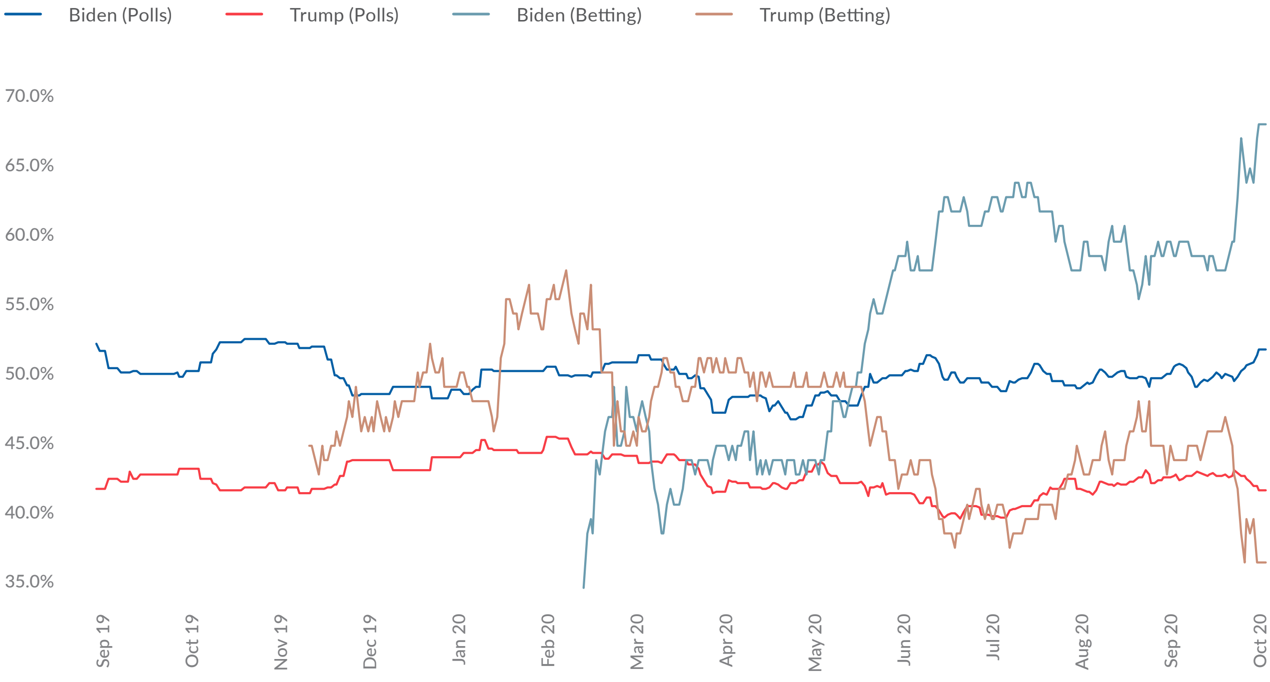
Polls

We analyse the elections in three sections: The Presidential Election, Senate elections, and House of Representatives elections, each of which has slightly different implications for what happens over the next four years.

President

Polling aggregates have Joe Biden slightly ahead at **52% vs. 42%,** while the betting markets have a significantly bigger lead for Biden.

Figure 3: Trend of polling and betting odds for 2020 US Presidential Election
Source: Anchor, Bloomberg, PredictIt, Real Clear Politics



However, as described above, based on the electoral vote system, the popular vote is not always a good indicator of the outcome of the Presidential Election and we will discuss that under the "swing states" section later in this note.

Senate

Betting odds currently have a **68%** chance of the **Democrats** ending up with control of the Senate.

Figure 4: Trend of polling and betting odds for 2020 US Senate elections
Source: Anchor, Bloomberg, PredictIt

The Senate is currently controlled by the Republicans.

Figure 5: Current US Senate representation
Source: Anchor

Democrats   Republicans

Class	Democratic	Independent	Republican	Total	Next Election
1	21	2	10	33	2024
2	**12**		**21**	33	2020
3	12		22	34	2022
Total	45	2	53	**100**	

Class 2 senators are up for election in November, along with 2 seats which are vacant because of a death and a resignation, so there are 35 Senate seats up for grabs at this election. At least 7 of those are going to be a very close call, leaving the outcome quite tightly balanced. The 2 independent seats in the Senate (which are not up for grabs), typically vote with the Democrats. Should the Senate end up evenly split (50 seats each), the outcome of the Presidential Election becomes even more important as the vice president gets the deciding vote when there is a tie in Senate voting.

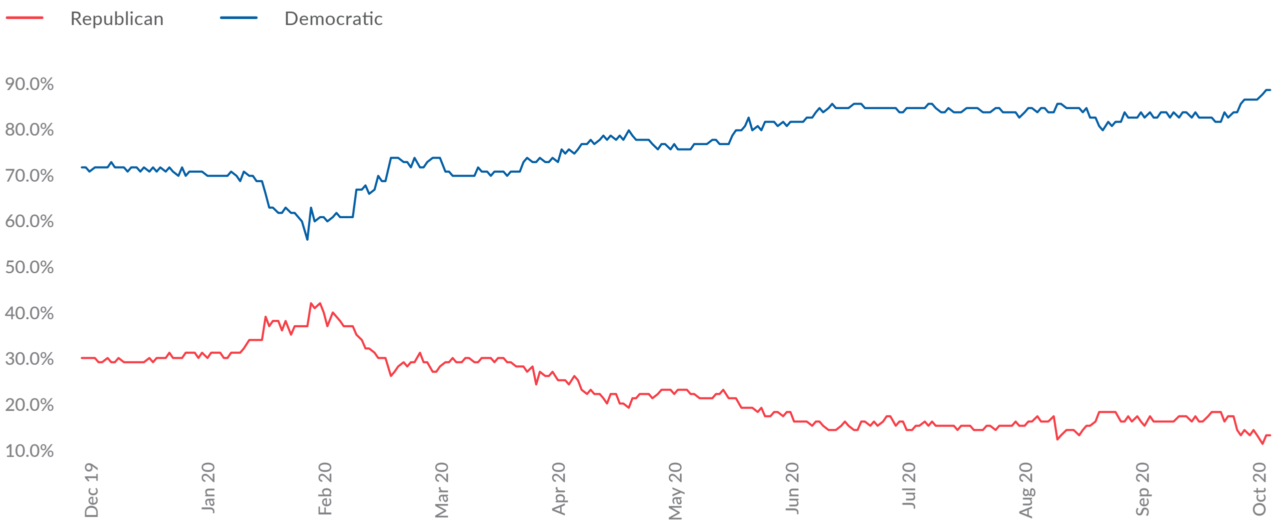
Figure 6: A breakdown of US Senate seats up for grabs in the 2020 Presidential Election
Source: Anchor

	Senate		
	Democratic	Independent	Republican
Not up for election	33	2	30
Up for election	15		20
Very safe	7		10
Somewhat likely	4		7
Close call	4		3
Possible total	48	2	50

The House of Representatives

Democrats currently control the House and are expected to comfortably keep that control.

Figure 7: The trend of polling and betting odds for the 2020 House of Representatives election
Source: Anchor, Bloomberg, PredictIt



SWING STATES

States representing around 60% of the 538 electoral votes on offer at the Presidential Election are usually quite consistent in terms of their allegiances. Those electoral votes usually given to each presidential candidate amount to about 165 "safe" electoral votes to begin with, meaning that a **presidential candidate typically needs about 105 electoral votes from so-called swing states** (which do not always have a strong allegiance) in order to win the presidency. The US electoral system's winner-take-all approach to allocating electoral votes means that **states like Florida, with 29 electoral votes on offer, can swing the result fairly decisively** in favour of either candidate. *Figure 8* below shows some of the states where the outcome is in the balance. Where polling is available for these states it currently strongly favours a positive outcome for Joe Biden, but with **a tight margin in those states representing at least 20% of electoral votes.**

Figure 8: Historical allegiance trends and current polling for states most likely to influence the 2020 Presidential Election outcome
Source: Anchor, Bloomberg, PredictIt

Democrats Republicans

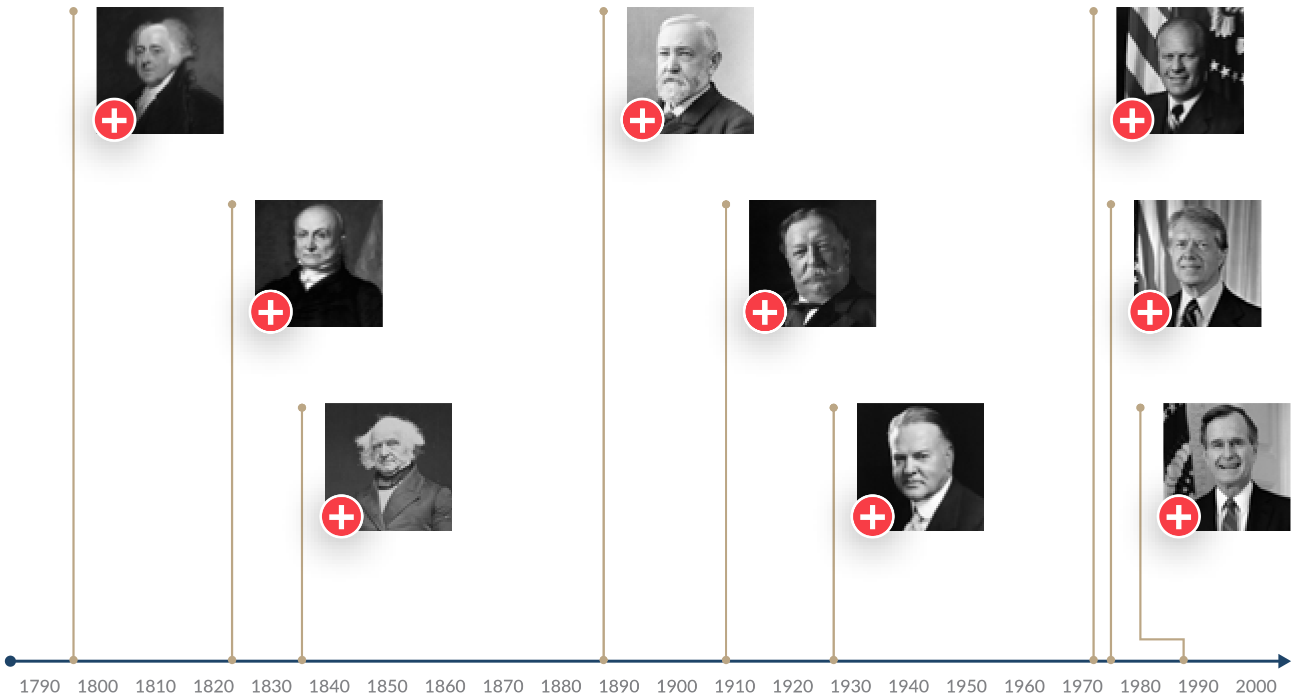
State	Republican	Democratic	Rep-Dem	Electoral Votes	2016	2012	2008	2004	2000
	D Trump				D Trump	Mitt Romney	John McCain	GW Bush	GW Bush
		J Biden			H Clinton	B Obama	B Obama	J Kerry	Al Gore
Maine	39.0%	51.8%	**-12.8%**	4	**47.8%**	**56.3%**	**57.7%**	**53.6%**	**49.1%**
Minnesota	41.0%	50.4%	**-9.4%**	10	**46.4%**	**52.7%**	**54.1%**	**51.1%**	**47.9%**
N. Hampshire	43.0%	52.0%	**-9.0%**	4	**47.0%**	**52.0%**	**54.1%**	**50.2%**	**48.1%**
Nevada	43.7%	49.7%	**-6.0%**	6	**47.5%**	**52.4%**	**55.2%**	**50.5%**	**49.5%**
Virginia	40.3%	51.3%	**-11.0%**	13	**49.7%**	**51.2%**	**52.6%**	**53.7%**	**52.5%**
Colorado				9	**48.2%**	**51.5%**	**53.7%**	**51.7%**	**50.7%**
Wisconsin	44.0%	49.5%	**-5.5%**	10	**47.2%**	**52.8%**	**56.2%**	**49.7%**	**47.8%**
Michigan	42.7%	49.4%	**-6.7%**	16	**47.5%**	**54.2%**	**57.4%**	**51.2%**	**51.3%**
Pennsylvania	43.9%	51.0%	**-7.1%**	20	**48.2%**	**52.0%**	**54.5%**	**50.9%**	**50.6%**
Ohio	46.2%	46.8%	-0.6%	18	**51.7%**	**50.7%**	**51.5%**	**50.8%**	**50.0%**
Florida	44.3%	48.0%	**-3.7%**	29	**49.0%**	**50.0%**	**51.0%**	**52.1%**	**48.9%**
N. Carolina	46.9%	48.3%	**-1.4%**	15	**49.8%**	**50.4%**	**49.7%**	**56.0%**	**56.0%**
Arizona	45.7%	48.8%	**-3.1%**	11	**48.7%**	**53.7%**	**53.6%**	**54.9%**	**51.0%**
Georgia	46.7%	46.7%		16	**50.8%**	**53.3%**	**52.2%**	**58.0%**	**54.7%**
Iowa	45.8%	47.2%	**-1.4%**	6	**51.2%**	**52.0%**	**53.9%**	**49.9%**	**48.5%**
New Mexico				5	**48.3%**	**53.0%**	**56.9%**	**49.8%**	**47.9%**
Oregon				7	**50.1%**	**54.2%**	**56.8%**	**51.3%**	**70.0%**
Connecticut				7	**54.6%**	**58.1%**	**60.6%**	**54.3%**	**55.9%**
Delaware				3	**53.1%**	**58.6%**	**61.9%**	**53.3%**	**55.0%**

Swing States	**209**
Safe Dems	**165**
Safe Reps	**164**
Total EVs	**538**

US PRESIDENTS WHO DID NOT WIN RE-ELECTION FOR A SECOND TERM

Usually, the incumbent is at a distinct advantage when running for a second term. **In the past 100 years only four US presidents have failed to win re-election.**

Figure 9: A timeline of one-term presidents
Source: Anchor



Herbert Hoover bore the brunt of the public's frustration with the economic pain of the Great Depression during his first term, the other three presidents who could not win a second term were all in the past 50 years.

George Bush Snr.
(1989 –1993)
Republican
Bush's official White House biography describes his re-election loss this way: "Despite unprecedented popularity from this military and diplomatic triumphs, **Bush was unable to withstand discontent at home from a faltering economy, rising violence in inner cities, and continued high deficit spending.** In 1992, he lost his bid for re-election to Democrat William Clinton."

Jimmy Carter
(1977–1981)
Democrat
Carter's White House biography blames several factors for his defeat, not the least of which was the hostage-taking of US Embassy staff in Iran, which dominated the news during the last 14 months of Carter's administration. **"The consequences of Iran's holding Americans captive, together with continuing inflation at home,** contributed to Carter's defeat in 1980. Even then, he continued the difficult negotiations over the hostages."

Gerald Ford
(1974–1977)
Republican
Ford was never elected by the public as US president, he was appointed vice president when Spiro Agnew resigned and then became president when Richard Nixon resigned over his involvement in the Watergate scandal. "Ford was confronted with almost insuperable tasks," his White House biography states. "There were the **challenges of mastering inflation, reviving a depressed economy, solving chronic energy shortages, and trying to ensure world peace."** In the end, he could not overcome those challenges.

CAMPAIGNS

CONTROVERSIES

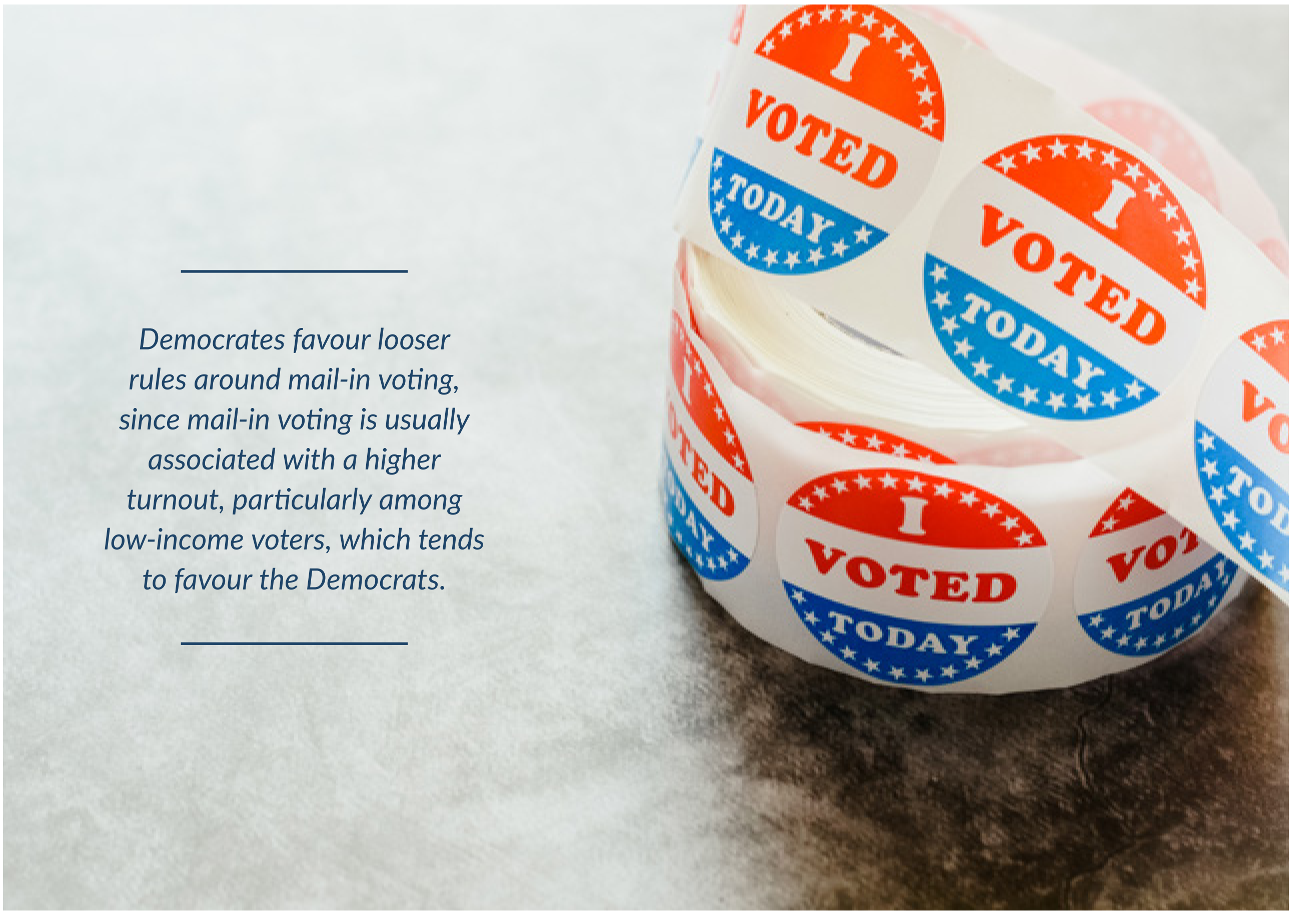
Mail-in votes: The US Postal Service (USPS) finds itself as one of the top issues for this Presidential Election, primarily as a result of the coronavirus which has put the postal service's balance sheet under pressure and increased the appeal of mail-in voting to avoid the risk of infection at crowded polling stations.

Mail-in voting/absentee voting has been around since the American Civil War for voters who cannot be physically present at their local voting station on voting day. Voters apply to receive a ballot form in advance of voting day, which they complete and mail in.

States tend to have differing legislation around who is eligible for mail-in voting. These range from "universal vote-by-mail" (where ballot forms are automatically sent to all voters), while at the opposite end of the spectrum some states require applicants for vote-by-mail to prove they have an approved reason for mail-in voting (away on voting day, elderly, disabled, or incarcerated). There are also differences in how mail-in voting forms are verified, with some states requiring signatures on ballot envelopes which must be checked against signatures on record, while other states do not check signatures.

In general, Democrats favour looser rules around mail-in voting, since mail-in voting is usually associated with a higher voter turnout, particularly among low-income voters, which tends to favour the Democrats. Trump has pushed back on mail-in voting, suggesting that it is "inaccurate and fraudulent". Republicans are trying to use the fragile state of the USPS financial situation as a reason why broader access to mail-in voting cannot work, blocking attempts by Democrats to pass funding bills that will help subsidise more mail-in voting.

There are numerous legal challenges in US courts pushing both sides of the mail-in vote agenda, so **it is very possible that, if the election is close, the counting of mail-in votes** (and the checking of signatures) **may delay the final results and that results influenced by mail-in votes may be subject to legal challenges.**



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POLICIES

Trump

(Still Make America Great Again, America First, and Promises Made, Promises Kept)

Trump's biggest challenge for this campaign is convincing Americans that his handling of the pandemic was sufficient and that he has been able to get the economy back on track. His policies are largely more of the same:

- Bring manufacturing jobs home (by protecting local manufacturers from foreign competition, particularly China).
- Bring American troops home (predominantly from Germany and Afghanistan).
- Change immigration to a "merit-based" system and eliminate chain migration (i.e. immigration based on family ties).
- Bring down drug costs.
- Address employment barriers for former prisoners.

Biden

(Restore the Soul of America, Build Back Better, and Unite for a Better America)

Biden will attempt to cast aspersions on Trump's handling of the pandemic and offer up a change in direction on policies:

- Create new economic opportunities for workers.
- Restore environmental protection (re-join the Paris Climate Agreement and spend $1.7trn over the next 10 years on green tech research).
- Criminal justice reform and grants for minority communities (reduce incarceration and address race, gender, and income disparities).
- Restore healthcare rights (additional government spending of $2trn-plus over the next 10 years).
- Restore international alliances (form alliances to challenge China's trade and environmental practices).
- Reverse Trump-era tax cuts.
- Reverse Trump's anti-immigration policies.
- Increase access to free college tuition, introduce universal pre-school, and provide student loan forgiveness.
- Coronavirus relief (small business loans and more cheques mailed out).
- Increase the federal minimum wage (from the current $11.50/hour to $15.00/hour).

THE POTENTIAL IMPACT ON MARKETS

Markets generally do not love uncertainty and there is a strong chance that this election result will be delayed due to mail-in voting and legal challenges. The last time the US had a close election where the result was delayed because of legal challenges was in the 2000 Presidential Election, where the result in Florida was ultimately decided by the Supreme Court more than a month after voting day. In the weeks after the vote, **the S&P 500 fell c. 8% as investors waited for the outcome to be decided.** This time around, the expectation of delays may take the edge off the uncertainty, but it is likely to still result in some market jitters. Markets are already anticipating lots of this uncertainty as the cost of hedging against equity market corrections around the time of the election is around 20% higher than current levels:

Figure 10: The cost of hedging against equity market corrections around election time is elevate
Source: Anchor, Bloomberg

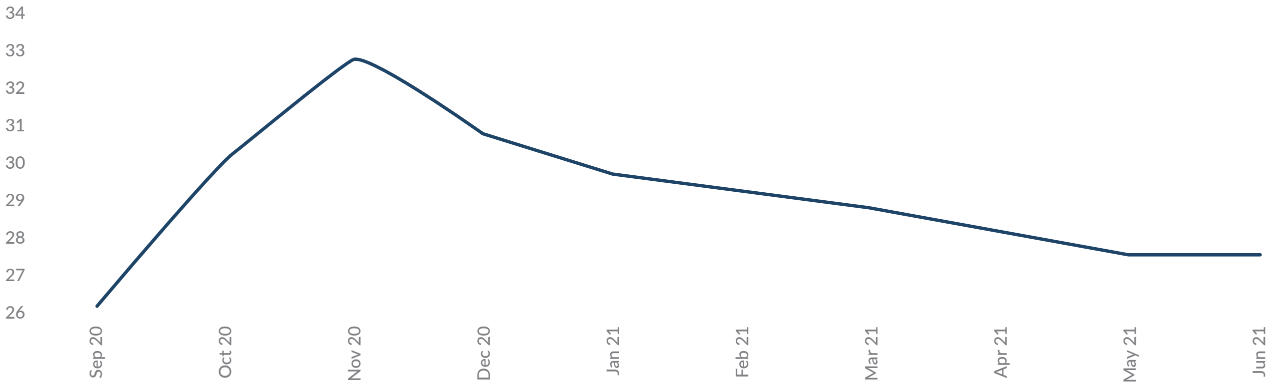


Figure 11: Most likely scenarios for the 2020 elections
Source: Anchor

🔵 Democrats 🔴 Republicans

	President	Senate	House
Current	🔴	🔴	🔵
Scenario A	🔵	🔵	🔵
Scenario B	🔵	🔴	🔵
Scenario C	🔴	🔵	🔵
Scenario D	🔴	🔴	🔵

Scenario A

(A Democratic sweep or blue wave) is likely to result in the biggest policy changes as Democrats pursue their policies aggressively, reversing course on those policies implemented during the Trump years.

Scenario B and C

(Where the Senate and the Presidency are split) will make it difficult for either party to pursue their agenda robustly and very little incremental policy changes will likely ensue.

Scenario D

(The status quo) is unlikely to see significant changes in policy as the Republicans maintain course on existing policies.

Polling currently suggests that Scenario A is the most likely outcome and, as markets are generally forward looking, it is probably fair to say that this outcome is already reflected to a certain extent in current asset prices.

THESE ARE THE SECTORS AND ASSET CLASSES WE THINK ARE MOST LIKELY TO BE IMPACTED BY THE ELECTIONS:

Interest rates

- *Fiscal policy:* Democrats are keen to increase spending (somewhat offset by higher taxation), so in the event of a blue sweep allowing them to pursue those policies, that could put slight upward pressure on US rates to the extent the central bank is not able to absorb all the additional bonds issued to increase the deficit.
- *Monetary policy:* The Federal Open Market Committee (FOMC) is theoretically independent, but 7 of its members tend to have an outsized influence, including the 3 supervisory positions (chair, vice-chair, and vice-chair for supervision) all of which will be up for election during the next presidential term. As such, the president can choose candidates that are likely sympathetic to their hopes for monetary policy. Trump, in particular, has been outspoken on his hopes for looser monetary policy and thus a Trump presidency could see a chipping away at central bank independence and a stronger likelihood of "lower-for-longer" rates.

The US economy

- **A blue sweep should allow Democrats to increase fiscal spending, which generally acts as a bigger short-term boost to economic activity than the resultant tax hikes are able to offset in the short- to medium-term.** Longer term, the impact of larger deficits could act as a drag on economic growth.

US equity markets

- Democrats are keen to partially reverse the cuts to US corporate taxes that the Trump administration was able to achieve from the end of 2018 (US corporate taxes went from 35% to 21%). **Democrats would like to reverse half of the corporate tax cuts (i.e. raise taxes from 21% to 28%). Trump's tax cuts were at least partially responsible for a c. 20% re-rating in US equity markets** at the beginning of 2019, so in the case of a blue sweep allowing for the partial reversal of those cuts, it is probably fair to assume that up to half of that re-rating could reverse. However, with Democrats ahead in the polls some of that may already be in the price.

Big Tech

The biggest threats to Big Tech are:

- **Changes to their ability to recognise earnings in low-tax jurisdictions,** which the Democrats are keen to challenge via a 15% minimum tax rate on book profits and a doubling of foreign tangible income taxes from 10.5% to 21%.
- **Falling foul of anti-trust regulations**, which probably involves a shift in how the judiciary interprets existing anti-trust regulations. Currently, the Supreme Court leans towards the "Chicago School" of competition policy thinking, which only really considers the impact on consumer welfare. For anti-trust to become a bigger threat to Big Tech it would require a shift in thinking of the Supreme Court to a more neo-Brandeisian approach that considers factors such as monopsony power in the labour market and excessive political influence of large corporations. Democrats are likely to lean towards Supreme Court nominees with a more neo-Brandeisian way of thinking should vacancies arise, but a shift towards that way of thinking for the majority on the Supreme Court bench is probably a long way off.

Banks

- With the Fed's vice-chair of supervisory due for appointment during the next presidential term, a Biden presidency could see the introduction of someone more likely to reverse course on the recent easing in bank regulation around proprietary trading. Democratic campaigning has not focused on vilifying the banks this time around, so it is unlikely that bank regulations will be a big focus in the case of a blue sweep.

Pharma

- Both parties have mentioned an aversion to high drug pricing in their campaigns, though with a slightly different approach to tackling it.
- Current legislation gives government very little power to regulate commercial drug pricing, so a meaningful change in drug pricing requires a change in legislation. Democrats are most likely to pursue that but will probably struggle to achieve it without a 60% control of Senate, which is highly unlikely.
- Major US pharma has about 20% exposure to US government payers, 30% exposure to commercial insurers, and the remainder offshore.

Energy

- Upstream energy (drillers etc.) are likely to suffer in a scenario with major Democratic influence which could introduce a ban on new permits on federal land and public waters.
- Renewable energy is likely to be a significant beneficiary in the event of a blue sweep, with ambitious plans for federal spending on green energy.

China

- Both parties have campaigned on anti-China rhetoric, but with Democrats favouring an approach that involves building global alliances to pressure China. Meanwhile, Republicans will likely continue with a more direct strategy that involves tariffs etc. The Republican strategy is more likely to involve risk for investments in individual Chinese stocks, which run the risk of more targeted attacks.

Apple vs Fortnite developer Epic Games:

The battle for control of app store fees

Written By:

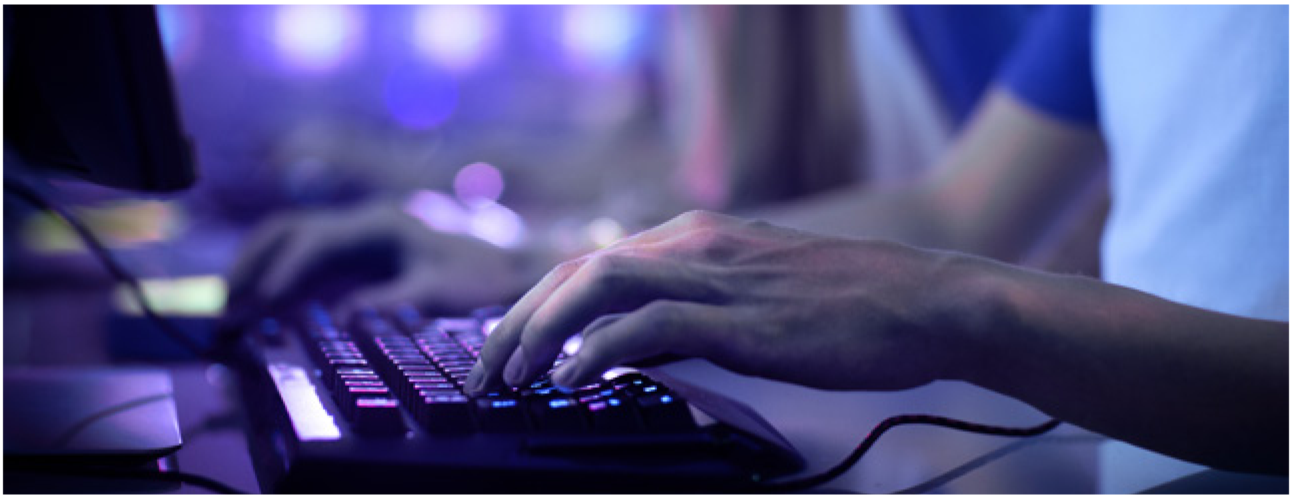
Seleho Tsatsi
Investment Analyst

Epic Games, the 40% Tencent-owned developer of the hit online video game, *Fortnite* and game creation/ development platform, *Unreal Engine*, which is used by c. 50% of the video game industry to create video games, recently publicly criticised Apple for its App Store policies. Although other companies have in the past complained about Apple's policies, Epic's complaints are particularly noteworthy given *Fortnite's* cultural and financial significance – the game has become a cultural phenomenon, with c. 350mn registered users.

On iOS (Apple's mobile operating system) alone, users have spent c. $1.2bn on *Fortnite* since its launch in July 2017. In this note, we examine the Apple App Store's fees and policies, look at the reasons why Epic is unhappy about these fees and policies, and discuss the current battle between the two companies.

WHAT FEES DOES THE APPLE APP STORE CHARGE?

Apple charges app developers a 30% commission rate when App Store users download paid apps or make in-app purchases. However, there are subtle distinctions to that 30% figure. For example, in the case of subscriptions the commission drops to 15% after 12 months, while in the event of the purchase of physical products or services via an iOS app, Apple does not charge a commission. For multi-platform apps (e.g. desktop and iOS), content may be accessed without Apple collecting a fee. For example, a subscription purchased on a desktop can be accessed in the iOS app without Apple collecting a fee, although apps cannot divert users away from making in-app purchases (through mechanisms such as external links that bypass the App Store) to avoid paying App Store fees.



WHAT IS EPIC UNHAPPY ABOUT?

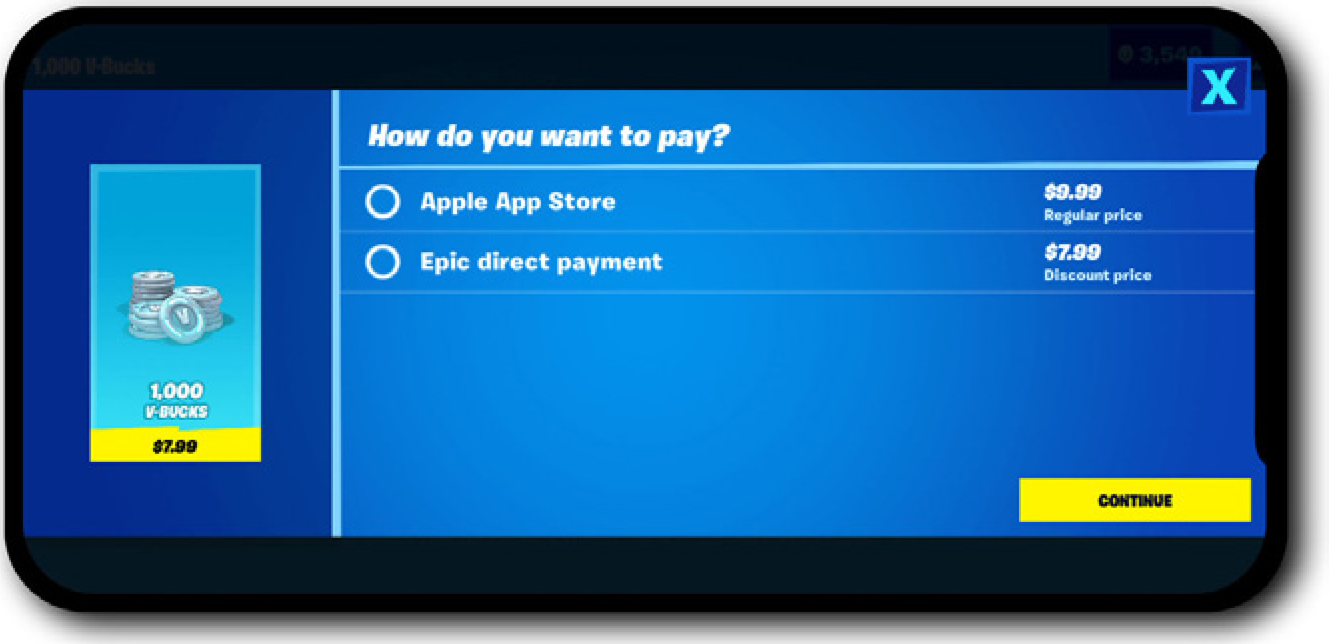
Epic's unhappiness with Apple can be categorised into three complaints. First, Epic believes the 30% commission rate which Apple charges is exorbitant. Consumers, in Epic's view, pay higher prices for apps as a result. Epic points to competing payment processing services such as Visa, MasterCard, and PayPal, which charge 2.5% to 3.5% in commission.

Second, Epic believes that Apple has monopolised access to its user base of over 1bn iOS devices because iOs device users cannot install software directly from developers. Instead, consumers have to use the Apple App Store to access this software, forcing developers to give Apple a 30% cut of their sales as commissions. Android is an open platform (i.e. Google allows third-party software to be installed via the web), but Google Play enjoys a majority market share for Android stores. Finally, Epic also accuses Apple of restrictive App Store policies which stifle innovation, arguing for example, that the World Wide Web would have been blocked by Apple if it had been invented after the iPhone. That is because within its App Store, Apple does not allow code or content that Apple has not reviewed or the ability to accept payments directly from consumers.

WHAT HAS EPIC GAMES DONE ABOUT IT?

Epic gave users the ability to bypass Apple and Google's payment systems. *Fortnite* players could use Epic's direct payment option and pay lower prices as a result (see *Figure 1*). In response, Apple blocked new *Fortnite* installations and even *Fortnite* updates on the App Store. Google has also blocked *Fortnite* from Google Play. In addition, Apple terminated Epic's developer accounts, which means that Epic cannot make software for any Apple devices, whether that software is *Fortnite*, other Epic games or *Unreal Engine*.

Figure 1: Epic's direct payment option
Source: Epic Games



WHAT IS APPLE'S ARGUMENT?

Apple argues that its commission rates are comparable to that of other digital marketplaces. Consulting firm, *Analysis Group* did a study (which Apple supported) on digital marketplace commission rates, which showed that the Apple App Store's commission rates were comparable to those of other app stores (see *Figure 2*), video game marketplaces (see *Figure 3*), digital content platforms (see *Figure 4*), and e-commerce marketplaces (see *Figure 5*).

Figure 2: Various pp store commission rates
Source: Analysis Group

Store	Commission Rate
Google Playstore	30% (15% for subscriptions after 12 months)
Amazon Appstore	30% (20% for video streaming subscriptions)
Samsung Galaxy Store	30% (or otherwise agreed-upon)
Microsoft Store	30% on games
	30% on all sales in Business and Education stores
	30% for Windows 8 devices
	15% otherwise
Apple App Store	30% (15% for subscriptions after 12 months)

Figure 3: Various video game marketplace commission rates
Source: Analysis Group

Marketplace	Commission Rate
Xbox	30% (15% for non-video game subscriptions)
PlayStation	30%*
Nintendo	30%*
Steam	30% for sales below $10 million
	25% for between $10 million and $50 million
	20% for above $50 million
Epic Games	12%

*Commission rate from third-party sources, not disclosed by the marketplace.

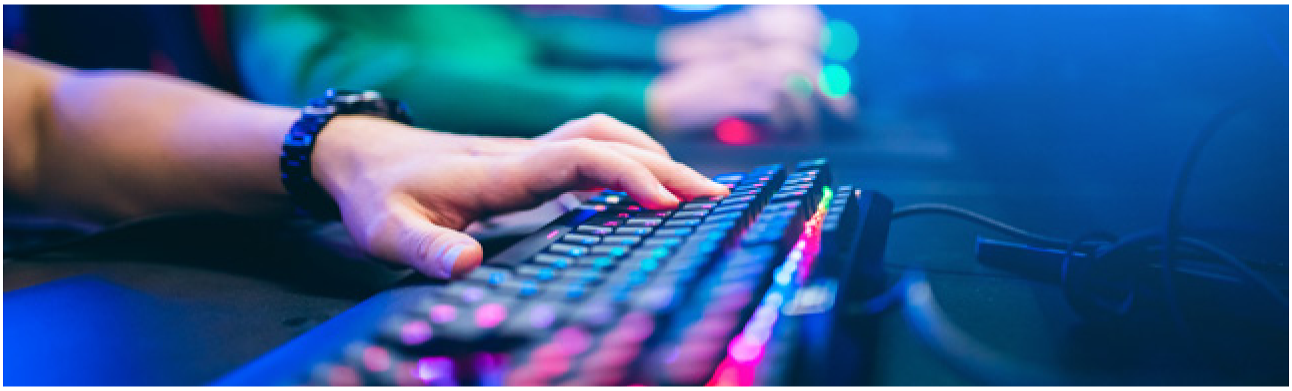


Figure 4: Digital content platform commission rates
Source: Analysis Group

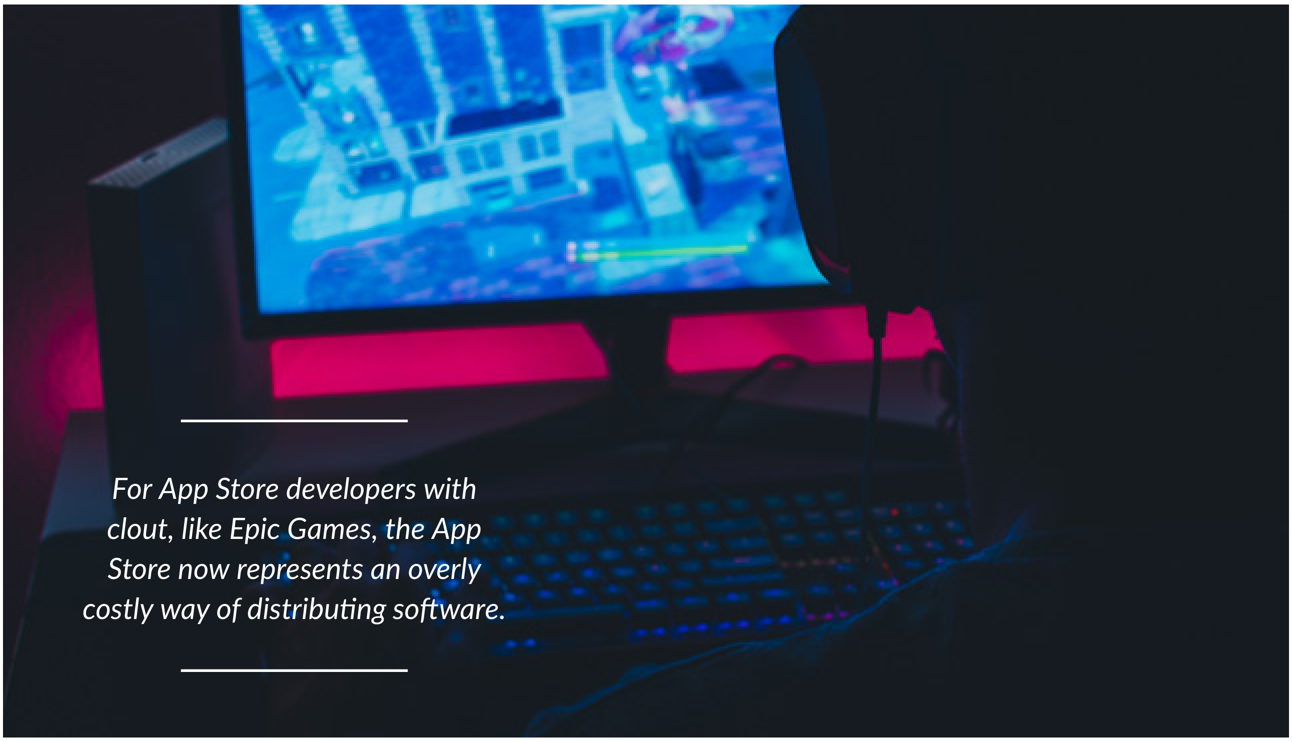
Platform	Commission Rate
Anchor by Spotify	30% on sponsorships (advertising)
	9.5% on listener donations (including 5% payment processing fee)
Anchor by Spotify	50% on net subscription revenue
	25% (minimum) on advertising revenue
Roku	20% on pay-to-install or in-channel purchases
	30% of advertising inventory
YouTube	45% on advertising revenue*
Amazon Prime Video Direct	50% on purchase and rental revenue
Kindle Direct Publishing	30% for eBooks between $2.99 and $199.99
	60% otherwise
Nook	35% for eBooks between $2.99 and $199.99
	60% otherwise
Kobo	30% for eBooks $2.99 and above
	55% for eBooks below $2.99
	55-68% for audiobooks
Audible	60% for exclusive content
	75% otherwise
Patreon	7.9%, 10.9% or 14.9% depending on features

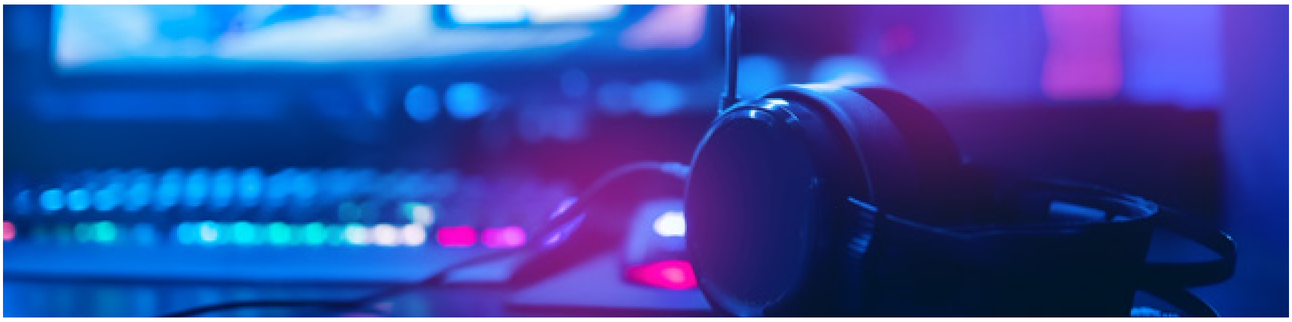
Figure 5: e-commerce marketplace commission rates
Source: Analysis Group

General Retail	
Amazon	8-17%
eBay	10-12%
Etsy	5% plus 3% for Etsy Payment
Walmart	6-5%
Poshmark	20%
Ridesharing	
Uber	~25%*
Lyft	~20%*
Freelancing Services	
TaskRabbit	15%
Upwork	20% below $500
	10% for $500-$10,000
	5% above $10,000
SoundBetter by Spotify	5%

Travel	
Airbnb	17.2%
	14-20%
	20% for Experiences (including online ones)
Booking.com	15% on average
VRBO	18-19%
Ticket Resale	
StubHub	~37%*
Ticketmaster	~31%*
Food Delivery**	
Uber Eats	15-30%
Grubhub	23-33%

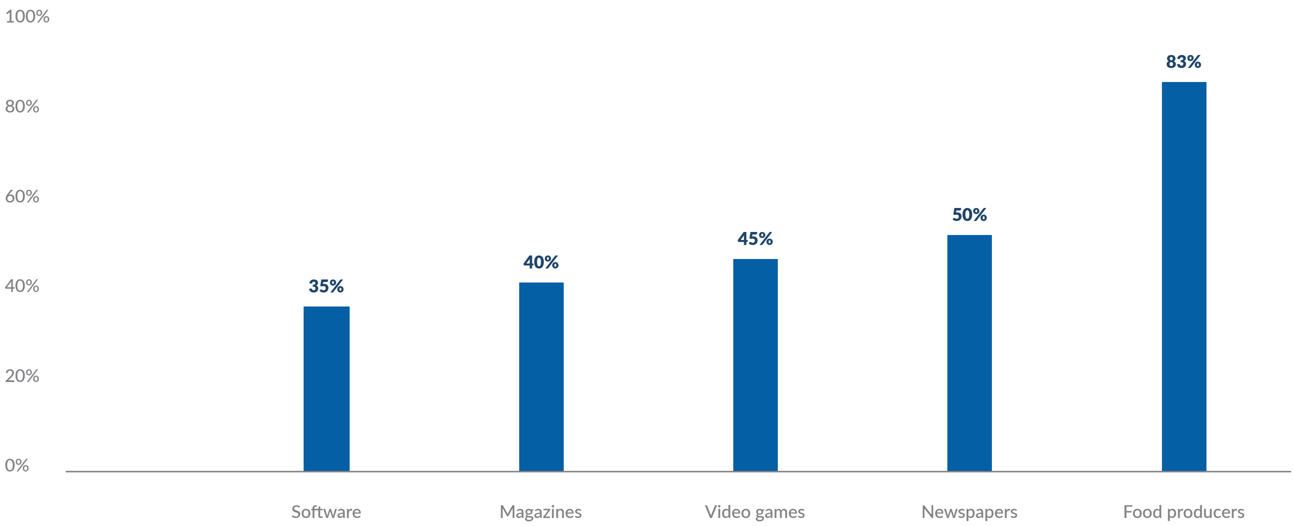
*Commission rate from third-party sources, not disclosed by the marketplace.
**Standard seller commission rates only.





The study also argues that Apple's commission rates are very attractive to developers when compared to the low proportion of sales that software and content developers receive from sales in the brick-and-mortar world. As *Figure 6* below shows, software developers retain about 35% of a boxed software retail price, while video game developers keep slightly more (about 45%). The study estimates that physical production and distribution costs account for 50% and 60% of newspaper and magazine sales, respectively, while food producers typically pay retailers 15%-20% of sales for in-store placement.

Figure 6: The percentage of the brick-and-mortar retail sales price retained by developers/publishers
Source: Analysis Group



Apple points to several other benefits of its App Store, including the fact that it charges no commission on purchases of physical products and services through the Apple App Store (i.e. a commission is only charged on digital goods). Developers set the prices for apps on the App Store.

The app review process ensures all apps are safe and meet performance, design, and legal standards. Apple invests significantly in its ecosystem and its transaction-based commission rates help smaller developers by lowering the upfront costs of entering the market.

It remains to be seen how this fight over the App Store will play out. For Apple, App Store fees represent an important part of its push to have its services segment become a major growth engine for the company.

For App Store developers with clout, like Epic Games, the App Store now represents an overly costly way of distributing software to a user base of over 1bn iOS devices. However, what does seem to be a certainty is that the status quo is unlikely to continue indefinitely.

Apple vs Epic Games is set to go to trial in May 2021.

Investing for dividends

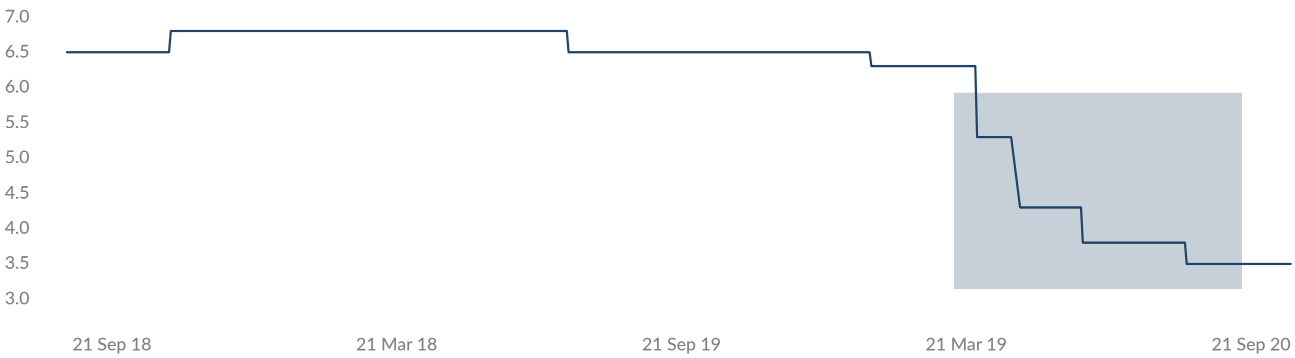
Written By:

Glen Baker
Fund Management

An investor's ability to select those shares with a high probability of receiving healthy portions of a company's profit , on a sustainable basis, has always been an attractive and sought-after quality. Higher dividend yields (as measured by the dividends paid per share/ share price) have often been described as "defensive", and sometimes even as an indicator of "value" with an overlay of "quality."

However, the COVID-19 pandemic has had a marked impact on global investment markets, and SA is no exception. Investors' risk-free income streams have been dramatically reduced because of the multiple interest rate cuts announced by the SARB.

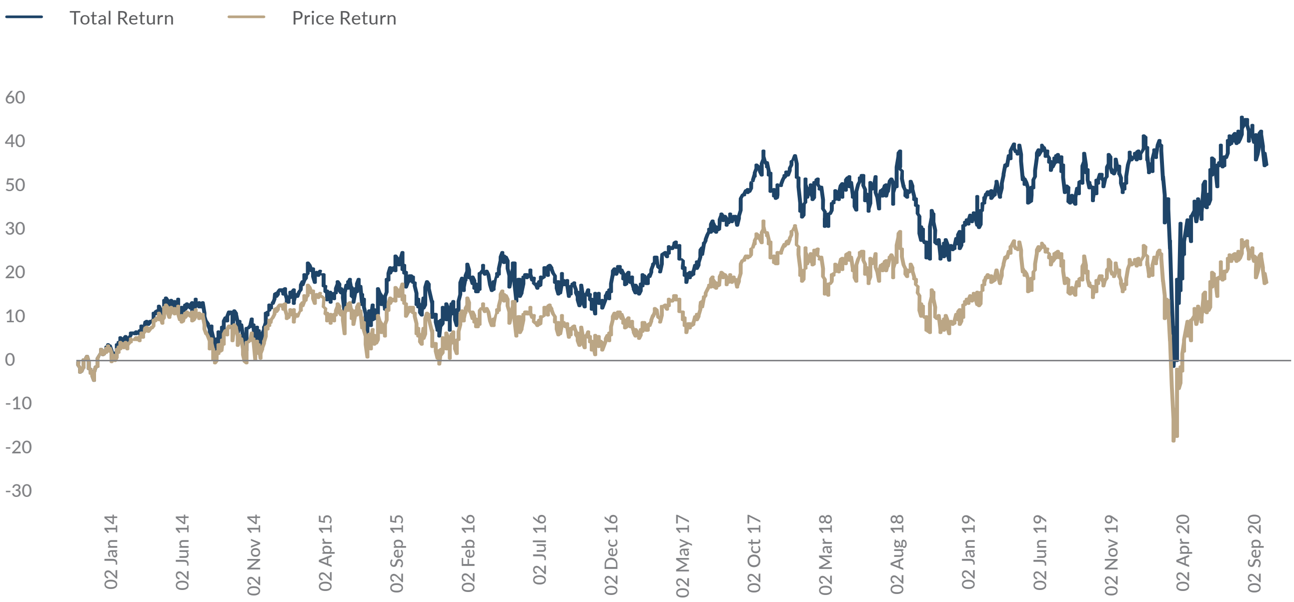
Figure 1: SA Reserve Bank repo rate
Source: Anchor, Refinitiv



This means that the search for yield has reached our shores for the first time in many years, as short-term interest rates have fallen, with the average money market collective investment scheme (CIS) return now at an annualised 4.5% and the income taxed at relevant rates in the hands of the investor. Although longer-term SA government bonds are still offering decent yields (the SA 2030 bond offers 9.45%), fiscal deficits have ballooned, and IMF loans are being utilised for the first time. All of the above also means that risk of capital loss does exist if the situation worsens and/or the SA government has to keep issuing debt. In our view, the consequence of this is that the widest possible available range of instruments and assets should be on the radar of those investors requiring an income.

At an overall equity market level, dividend yields have supplied a fairly surprising portion of total returns to local investors. In SA, as measured by the FTSE JSE All Share Index, 60% of total returns have been gained through dividend payments over the past c. 7 years.

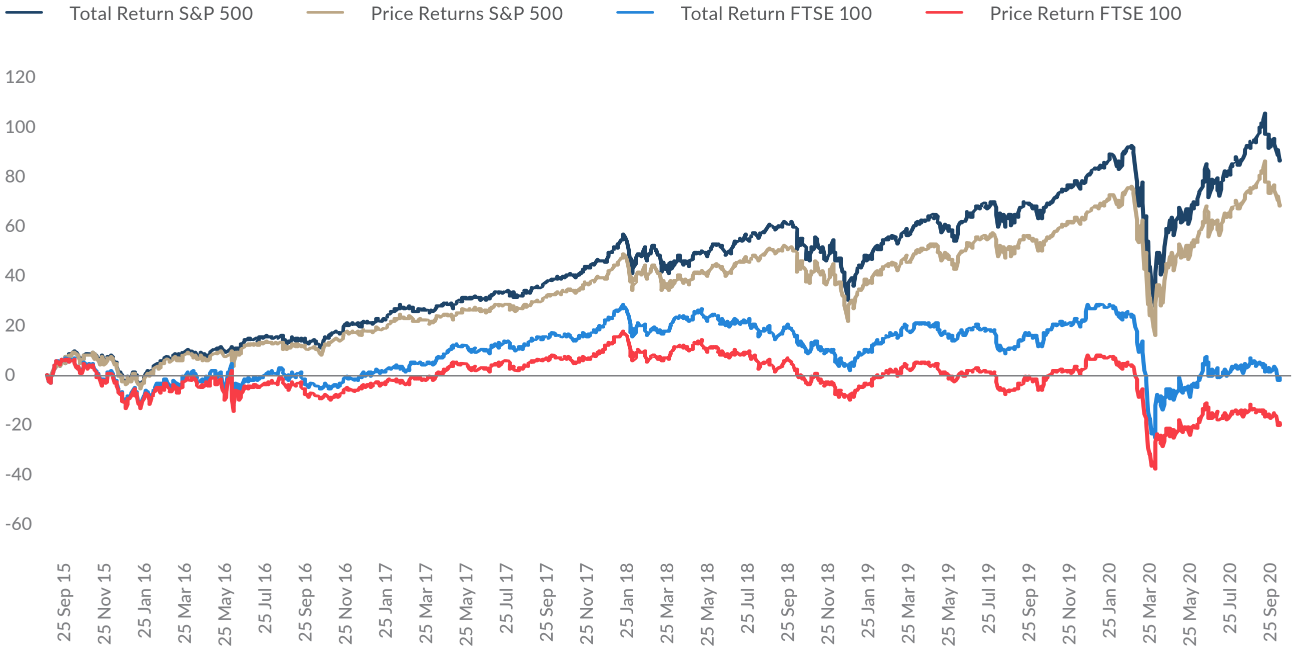
Figure 2: FTSE JSE All Share Index return, 1 January 2014 to date (%)
Source: Anchor, Refinitiv



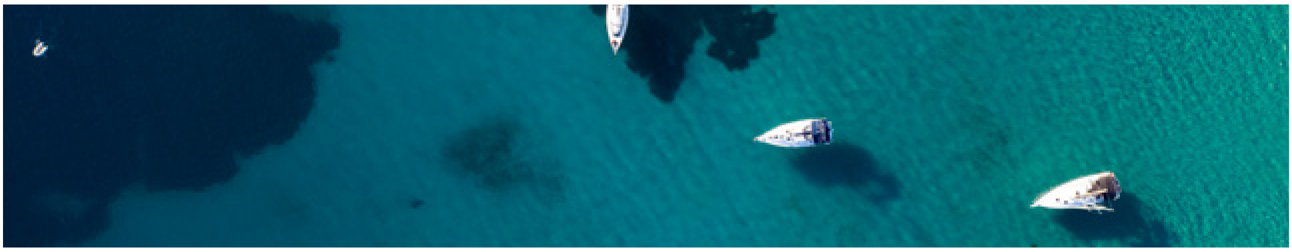
However, when looking at offshore markets, although their respective dividend contributions are proportionately less than that of the JSE, they remain important.

We highlight that, where the S&P 500 Index recorded good returns, the dividend component was less. Conversely, where returns were less impressive, the dividend component acted as a defensive buffer in the total return equation. This is illustrated by the FTSE 100 Index in *Figure 3* where, over the past 5 years, the return is a negative 4.3% on annualised basis, but only a negative 0.4% p.a. once dividend payments have been considered.

Figure 3: The S&P 500 and FTSE 100 total returns over the past 5 years, % in US dollar terms
Source: Anchor, Refinitiv

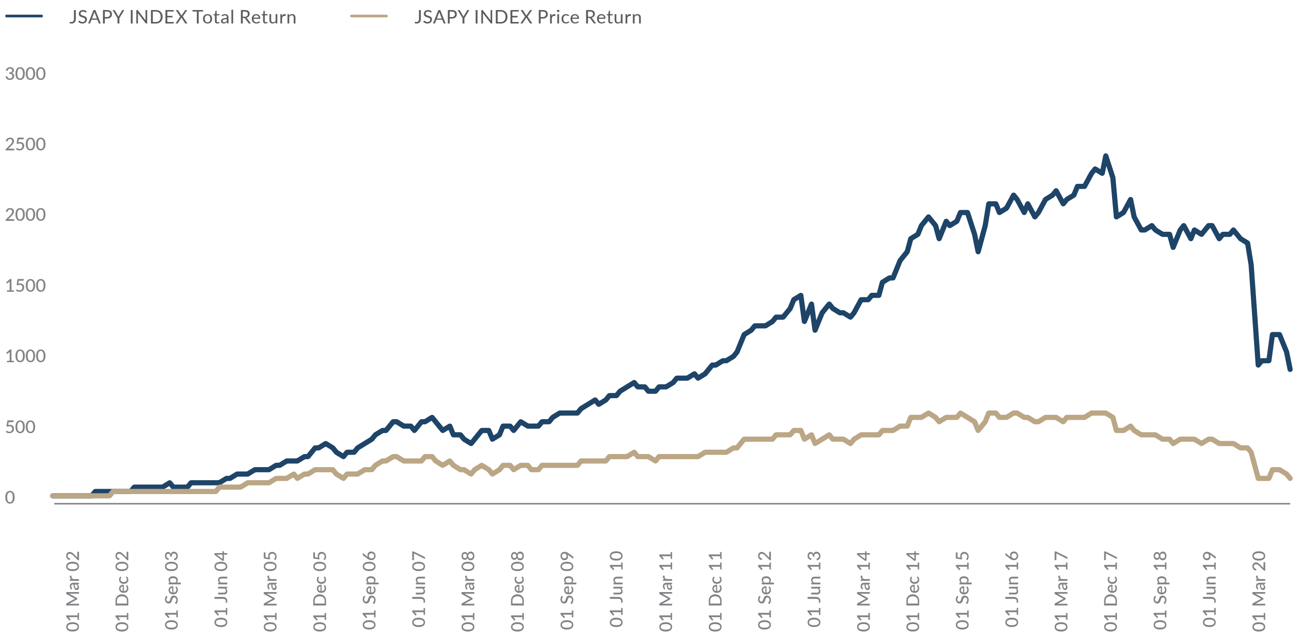


Certain sectors, with companies that pay out relatively large portions of their net profit as dividends, have historically been well supported by investors seeking income and the prospect of capital growth, which is less apparent in fixed-coupon paying, debt instruments issued by sovereigns, SOEs, and corporates. In this regard, we highlight the performance of the SA listed property sector. Investors poured into this sector from the mid-2000s, based on good yields. This was accentuated by the regulatory requirement that property companies pay out at least 75% of their earnings if they wanted to be classified as REITs, and rental income growth, which led to these companies' share prices re-rating.



Nevertheless, the correction that has since transpired, based in part on the hubris in the sector during the period and in part by this year's COVID-19 pandemic, has shown the importance of maintaining continuous cash flows, and how investment cycles can quickly change this outcome.

Figure 4: The FTSE JSE SA Listed Property Index (JSAPY) price and total return, %
Source: Anchor, Refinitiv



The points highlighted above help to frame the outline of investing for dividend income which, at Anchor, has three pillars:

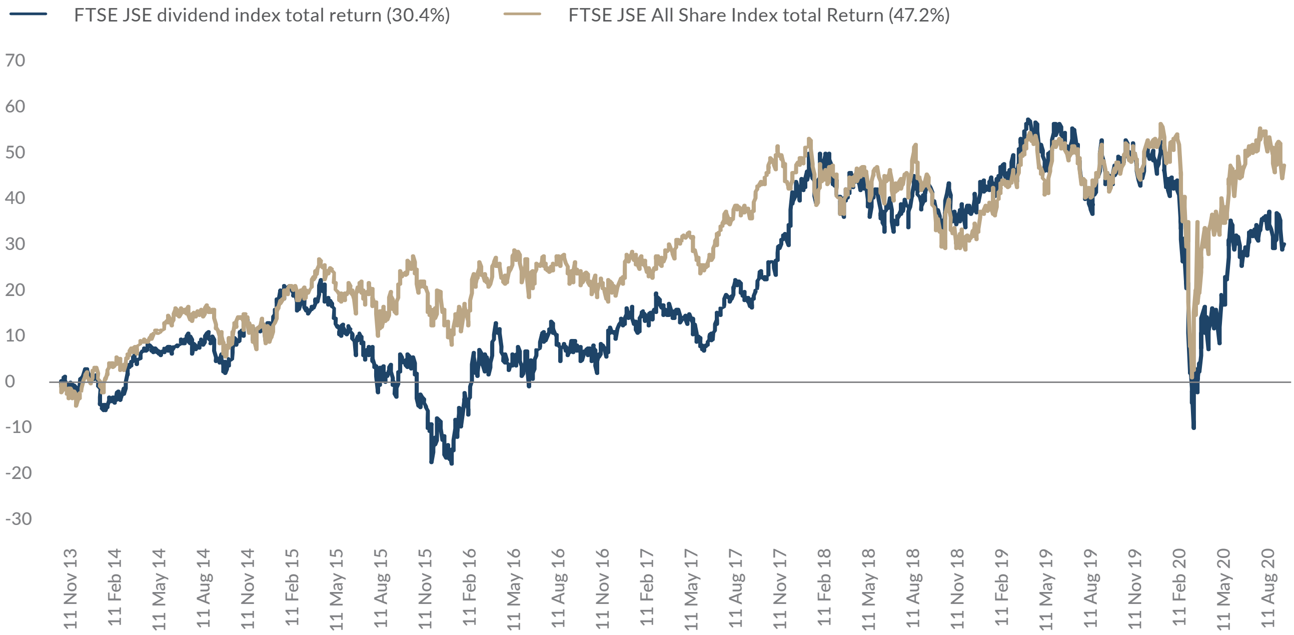
1. RELIABILITY OF INCOME, BASED ON FORECASTABLE EARNINGS

Companies are unlikely to pay dividends if they have no free cash flows available. This means the probability of our earnings forecasts being met for the investable universe which we analyse is of critical importance. As bonds are categorised by the quality of the bond issuer, we seek to do a similar exercise for equities.

2. THE HIGHEST YIELD DOES NOT NECESSARILY EQUAL THE HIGHEST REWARD - THE RISKS OF A DE-RATING

High-quality companies that can grow earnings over time and have a consistent payout policy will be the best-performing companies in the equity yield space. Very often, the highest forecast dividend yields are for those companies which are perhaps likely to experience lower dividends. In SA, the method for constructing the FTSE JSE Dividend Index (FTJ259) is through ensuring that those stocks with the highest forecast dividend yields also have the largest weightings in the index. This has often led to this benchmark being more volatile than the FSTE JSE All Share Index as high forecast yields failed to materialise, leading to an underperformance by the index.

Figure 5: FTSE JSE Dividend Index vs FTSE JSE All Share Index, % change over the past five years
Source: Anchor, Refinitiv



3. UNDERSTANDING CASH FLOWS

How a company generates and expends cash is important. To identify quality companies in this regard, the analysis needs to include a deep dive into what genuine cash earnings are, and how this cash is utilised. Cash in minus cash out is a simple but pragmatic method of quantifying what is available to be paid to shareholders and builds a base for continuing success.

On the macro level, the construction of any income- and dividend-focused portfolio is equally important to the fundamental bottom-up qualities.

Below, we highlight the most important factors in this regard.

ASSET ALLOCATION

Dividends and income can come from multiple sources. The traditional method of portfolio construction is to allocate to assets that combine some certainty in income earned, with the prospect of capital growth. Based on their risk profile, these broad asset categories (higher-risk to lower-risk) are:

- Equities
- Equity hybrid products;
- Property;
- Bonds issued by corporates and SOEs;
- Bonds issued by sovereigns;
- Cash.

RISK MITIGATION

Because dividends are usually associated with companies paying dividends from earnings at various stages of the investment cycle, even stocks seen as defensive or consistent dividend yielders may underperform, sometimes appreciably (equity risk). In our opinion, it is often prudent to allocate some capital in a portfolio towards looking to derive an income, and to combine select shares to take advantage of capital growth, over time.

In this regard, stock weightings and a diversified portfolio are the key foundations of a dividend- and income-based portfolio.

STOCK SELECTION AND WEIGHTING

We believe that the pillars outlined earlier should be rated according to probabilities of occurrence. To measure this, we have a traffic light system of **green**, **orange** or **red.** A hypothetical example below shows that there is a difference between short-term and long-term time horizons for stocks. The current environments may either help or hinder a company's ability to pay dividends and/or grow earnings over the next 12 months.

Nevertheless, high-quality, cash-generating companies should have an advantage over time, enabling these companies to pay sustainable dividends. This analysis is then overlaid with the more subjective factor of what the risks are of the company de-rating, which would in turn lead to share prices falling and a capital loss. This incorporates aspects such as cyclicality, industry prospects, and share price volatility.

Figure 6: Anchor dividend yield traffic light system
Source: Anchor

- 🔴 High forecast risk - Earnings, cash flows and dividends - Higher probability of share price decline.
- 🟠 Medium forecast risk - Earnings, cash flows and dividends.
- 🟢 Low forecast risk - earnings, cash flows and dividends - Lower probability of share price decline.

	1-year			Yield p.a.	5-year			5-year yield p.a.
	Certainty of cash flows	Potential for growth	Risk of derating		Certainty of cash flows	Potential for growth	Risk of derating	
Company A	🟢	🟢	🔴	9.60%	🟢	🟢	🔴	10.00%
Company B	🟠	🔴	🟠	8.60%	🟢	🔴	🟢	8.00%

It is also possible that both company A and company B could be included in a dividend- and yield-based portfolio. The target is to balance the dividends paid and the yield extracted over the next 12 months, whilst also understanding the company's prospects over longer time periods.

Based on this methodology, in *Figure 7*, we highlight our top-five share picks to be included in an SA dividend portfolio.

Figure 7: The top-five stock picks in a SA dividend-based portfolio
Source: Anchor

🔴 High forecast risk - Earnings, cash flows and dividends - Higher probability of share price decline.
🟠 Medium forecast risk - Earnings, cash flows and dividends.
🟢 Low forecast risk - earnings, cash flows and dividends - Lower probability of share price decline.

Company	1-year estimate			Yield p.a.	5-year estimate			5-year yield p.a.
	Certainty of cash flows	Potential for growth	Risk of derating		Certainty of cash flows	Potential for growth	Risk of derating	
Equites	🟢	🟢	🟠	9.60%	🟢	🟠	🟠	10.00%
British American Tobacco	🟢	🟠	🟠	8.60%	🟢	🟠	🟢	8.00%
AVI	🟠	🟢	🟢	5.80%	🟢	🟢	🟠	6.50%
Vodacom	🟠	🟠	🟠	7.00%	🟢	🟠	🟠	6.00%
Standard Bank	🔴	🟠	🟢	6.60%	🟢	🟠	🟠	6.50%

In our view, the following sectors should also be included in a dividend-focused portfolio:

- Resource sector stocks. This will be based on 12-month income and their respective weightings will also be lower.
- Financial services, non-banks: Asset managers, particularly those with large payout ratios. Again, lower weightings based on the impact of the cyclicality of markets on assets under management (AuM).
- Certain property stocks operating in niche sectors, where the loan-to-value (LTV) ratios are low and rental incomes are reasonably secure.

Navigating change:

Endless opportunities for SA investors offshore

Written By:

Nichole Maroun
Assistant Portfolio manager

At Anchor, we strive to assist our clients with *navigating change* on a daily basis. In an article entitled, ***Invest(ing) In the other 99%,*** *dated 10 July 2019*, Anchor Portfolio Manager Darryl Hannington pointed out that, up until a few years ago, local equity investors were handsomely rewarded over a 10-year period, with the JSE achieving annual returns of 18%, including during the GFC. However, over the past 5 years, the JSE has underperformed relative to global markets in US dollar terms and, even more concerning, local market returns were barely beating SA inflation.

The COVID-19 pandemic has placed SA's economy on an accelerated downward trajectory, further reducing achievable growth on the local equity market. In addition, we have found that most local investors have a significant portion of their wealth exposed only to SA assets given Regulation 28 of the Pension Fund Act, past JSE market opportunities, and the "home-advantage" bias. At Anchor Private Clients, we believe that, as a global investor with an unconstrained global mandate, we are spoilt for choice in terms of offshore investment opportunities. Thus, we spend most of our time in the private client space advising our clients on the importance of becoming offshore growth tourists.

While this conversation on offshore investing has proven to be quite a difficult one to have with our clients, it is essential that it does happen! Generally, we find that those clients who have made their wealth within the constructs of SA and its history over the past 20–30 years, find it extremely difficult to disconnect themselves from their patriotism to the country, as well as from their financial goals, and the legacies they wish to leave their descendants.

In our view, for an investment to have the greatest chance of success, it needs to be backed by a tailwind of economic growth and the ability to gain exposure to relevant and important sectors of a country's economy. Unfortunately, the local economic and political climate over the past five years has not been favourable for business development and has also been unable to attract the capital required for the local economy to grow. According to the *World Bank*, SA's average GDP growth per capita over the past five years has been a negative 0.6% and that was before the COVID-19 pandemic! In stark contrast, the US, India, and China have recorded average growth rates of 1.8%, 5.8%, and 6.2%, respectively, over the same period.

In addition, the world has changed, and the importance of technology has massively increased. At present, we see very few opportunities to leverage off this very important sector in SA, especially given that Naspers is the only exposure to the sector available on the JSE. In contrast, when considering offshore technology exposure, there are innumerable options available to investors including such companies as Alphabet (Google), Amazon, Alibaba, Spotify, etc. Furthermore, Tencent (in which Naspers has a 31% stake) has outperformed its largest shareholder by 183% over the past 5 years. This means that an investor would have benefited significantly more from being invested directly in Hong Kong-listed Tencent rather than in JSE-listed Naspers.

In a recent presentation to the local pension fund industry, Anchor CEO Peter Armitage identified the returns investors achieved locally vs global market returns (see *Figure 1*). He calculated that, if you were invested in global equities over the past one- and five-year periods, you would have achieved returns of 3.4% and 7.5%, respectively. This compares with a local investor who would have generated -3.2% and 4.3%, respectively, over the same time periods.

Figure 1: Local vs global market returns by asset class
Source: Bloomberg, Anchor. Data to end of June 2020.

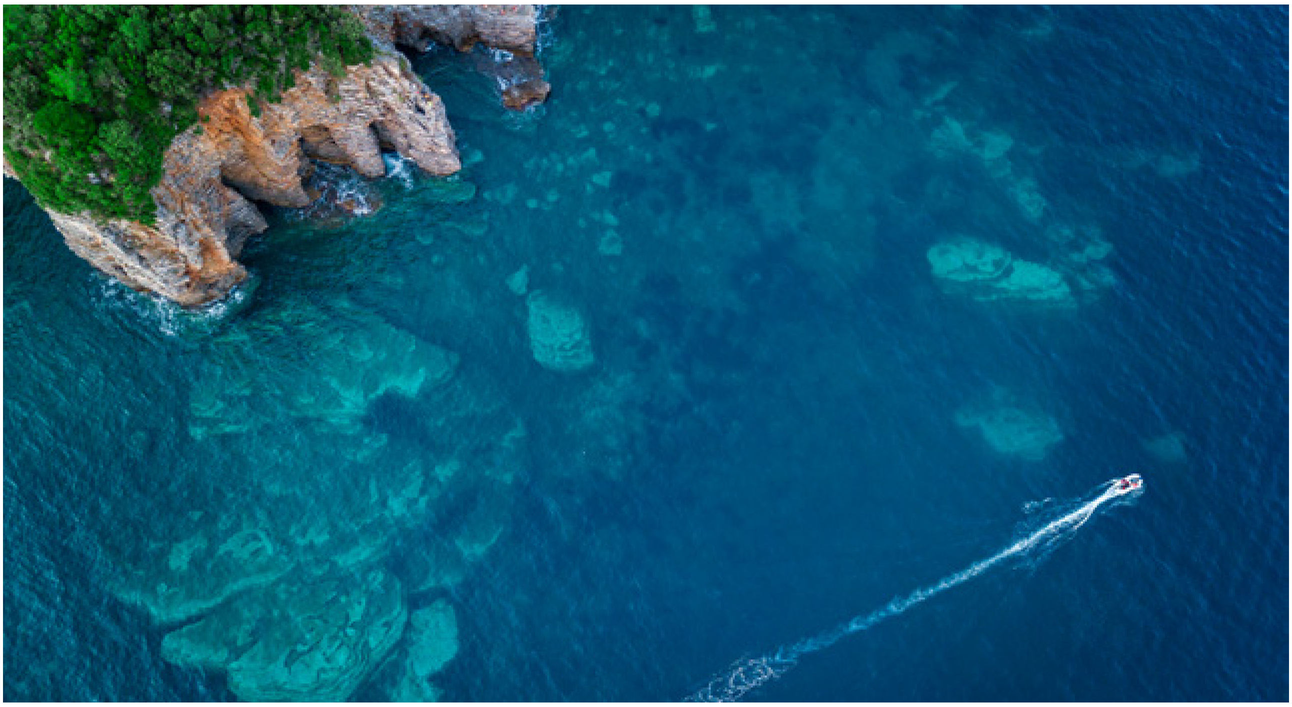
	Local currency returns (p.a)			Rand currency returns (p.a.)		
	1-year return	5-year return	10-year return	1-year return	5-year return	10-year return
Global equities	3.4%	7.5%	10.6%	27.4%	15.5%	20.1%
Global bonds	4.2%	3.6%	2.8%	25.5%	10.3%	10.8%
Global property	-15.0%	2.8%	8.2%	4.7%	10.4%	17.4%
Global cash	1.4%	1.2%	0.7%	22.1%	7.6%	8.1%
Local equities	-3.2%	4.3%	11.0%	-3.2%	4.3%	11.0%
Local bonds	2.9%	7.5%	8.3%	2.9%	7.5%	8.3%
Local property	-39.3%	-8.8%	4.7%	-39.3%	-8.8%	4.7%
Local cash	6.2%	6.9%	6.3%	6.2%	6.9%	6.3%

While we realise that hindsight is 20/20, and not an indicator of future returns, ultimately SA represents less than 1% of the global investable market, with a large concentration of risk in a few rand-hedge stocks. SA's position in the MSCI Emerging Market Index has also declined significantly - from 7% in 2015 to the current 4%, with Naspers alone representing 1.3% of that 4% weighting. As such, we see very little motivation for global investors to consider SA for EM growth exposure and our own choices as SA investors become so much vaster when considering a global investable universe. Currently, Anchor's largest market exposure is to the US, while we also have some exposure to India and China, since we believe that these countries represent the most attractive risk-adjusted market opportunities at present.

Our experience at Anchor has been that we can execute on our core investment philosophy with greater freedom using the broader toolset of an investment universe unconstrained by geography. Consider the high-level investment case for China's *Ping An Insurance* (a company we own in our High Street Equity Portfolio). *Ping An* is a leading Chinese long-term insurer and, much like our local insurers, it has become an integrated financial services business with lines into banking, wealth, and asset management, as well as other consumer-facing financial services products. It also operates in a country with a large emerging middle class and in an industry that provides a necessary service (insurance), which is still underpenetrated when compared to SA. Added to the attractiveness of the growth opportunities inherent in the *Ping An* investment thesis, is its undemanding valuation, a dividend yield of over 3%, and many years of double-digit growth in operating income ahead.

We see very little motivation for global investors to consider SA for EM growth exposure and our own choices as SA investors become so much vaster when considering a global investable universe.

Unsurprisingly, investing in high-quality companies (such as *Ping An*) and in industries where there is structural growth (like long-term insurance in China) is an easier decision for a portfolio manager to make than trying to pick a short cycle inflection point (possibly SA) in an underperforming economy or industry. We believe there are many more examples of the scenarios outlines above, for example in companies such as Russian food retailer *Magnit* compared with *Shoprite*, or *ICICI Bank* in India vs *Standard Bank*. So, while the practicalities of global investing may at first seem daunting to local investors who are new to offshore investing, Anchor will be there to assist you every step of the way, navigating the offshore investment process with you from start to finish.



Offshore trusts:
A brief explanation

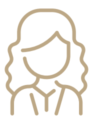
Written By:

Di Haiden
CEO, Robert Cowen Investments

In this article, we attempt to give the reader a simple understanding of an extremely complex subject which is ALWAYS very case specific. Although general principles may apply, the outcome for any client will be determined by their specific circumstances. Each client has to be analysed independently to decide on the application of an offshore trust and the case for, and against, using these structures. There is no 'one-size-fits-all solution' that we have come across in the 30 years we have been doing this.

WHAT IS A TRUST?

A Trust is a fiduciary relationship in which one party, known as a settlor or donor, gives another party, the trustee, the right to hold title to property or assets for the benefit of a third party, the beneficiary.



The settlor is the individual/entity who is responsible for setting up the Trust.

The trustee is the party who is being entrusted with the assets of the Settlor.

The beneficiaries are those who are going to benefit from the income and capital of the Trust.

WHY DO YOU NEED AN OFFSHORE TRUST?

An offshore trust has several advantages including legal protection of the settlor's assets, it allows for the efficient transfer of generational wealth.

WHERE DO YOU NEED AN OFFSHORE TRUST?

Several jurisdictions globally can be used for the administration and running of Trusts, but an important aspect is the tax treatment which applies in the jurisdiction chosen for the Trust. As a rule, offshore Trusts are set up in jurisdictions such as the British Virgin Islands (BVI), the Cayman Islands, Mauritius, and the Channel Islands – Jersey, Guernsey. Depending on the jurisdiction chosen, the Trust is governed by the legislation of the place where it is registered. A number of these places thrive on the employment generated by the Trust offices registered and run out of a particular jurisdiction. In general, SA residents use Mauritius and the Channel Islands.

SETTING UP A TRUST

Once an individual has chosen the jurisdiction the following has to be decided:

A Trust deed has to be drawn up according to the settlor's requirements such as who the beneficiaries are, what powers the trustees have, whether or not there is a protector.

The settlor is the person who settles the original amount on the Trust – a nominal amount of c. US$100. Usually the settlor is the person who has accumulated the wealth and wants to establish the Trust, but it can also be anyone the settlor may choose e.g. a parent.

The trustee: offshore Trusts have corporate trustees to ensure that the place of effective management (POEM) is not SA.

The beneficiaries: the people or entities who are going to benefit from the Trust.

The protector: an individual/company that has certain powers defined in the trust deed such as the hiring and firing of trustees.

THE TRANSFER OF ASSETS INTO A TRUST

Assets can be transferred into a Trust as a donation or as a loan. Donations attract a donations tax at 20% or 25%, depending on the amount of the donation. In addition, attribution of the income earned in the Trust may apply to the donor. A loan also has tax implications which vary, depending on the structure of the loan. A loan can either be interest-free or be interest-bearing. An interest-free loan is subject to Section 7C of the Income Tax Act No. 58 of 1962 (regarded as a donation of 20% on the deemed interest on the loan) and has capital gains and income tax implications for the lender. With an interest-bearing loan the interest earned is taxed at income tax rates; no other taxes usually apply. The interest-bearing loan agreement can be drawn up in the base currency of choice e.g. US dollar, Swiss franc, or South African rand. The interest rate (+1%) that applies to the currency will also apply to the loan.

THE TRANSFER OF FUNDS OUT OF A TRUST

Funds can either be distributed to beneficiaries OR loans can be repaid to the lender. There is no tax on capital repaid by loan account but there may be tax implications on distributions made. This depends on whether the capital or income is being distributed and is subject to the jurisdiction and the tax rules that apply in the country where the beneficiary is resident.

COSTS

Costs vary depending on the jurisdiction of the offshore Trust and the work involved in administering the Trust. Costs include setting up costs, trustee fees, administration, and accounting fees. In our experience these costs range from US$5,000–US$10,000 p.a. (excluding initial setup costs).

CONCLUSION

Please note that this article highlights general principles that apply to offshore trusts and it is very important to understand each settlor's intent and individual circumstances, as well as the tax residency of the people or entities involved, before final decisions are made. The devil is always in the detail and the final set up is very case specific.

In this article we have only scratched the surface of a very complex subject so we would suggest contacting RCI directly if you would like to have a conversation about setting up an offshore trust.

Performance Summary

	FUND PERFORMANCE							BENCHMARK PERFORMANCE					
	Start date	Annualised p.a. (%)	Since inception (%)	12-month (%)	6-month (%)	3-month (%)	Sep 20 (%)	Since inception (%)	12-month (%)	6-month (%)	3-month (%)	Sep 20 (%)	Performance vs Benchmark (%)
UNIT TRUSTS													
Anchor BCI Equity	Apr-13	8.0	78.0	-5.5	23.6	0.8	-4.2	48.1	-5.0	22.9	1.0	1.1	29.9
Anchor BCI Flexible Income	Jun-15	7.5	47.2	5.4	5.8	1.6	0.4	46.0	6.2	2.5	1.1	0.4	1.2
Anchor BCI Managed	Jan-15	3.4	20.7	2.0	20.5	1.6	-2.2	23.6	1.8	14.9	1.3	-1.8	-2.9
Anchor BCI Worldwide Flexible	May-13	11.6	125.0	10.4	20.7	6.0	-4.7	86.8	7.1	3.2	2.9	0.5	38.2
Anchor BCI Property Fund	Nov-15	-11.9	-46.4	-40.0	2.2	-12.9	-4.0	-50.8	-46.1	3.4	-14.1	-3.0	4.3
Anchor BCI Global Equity Feeder	Nov-15	19.5	140.0	81.3	58.5	12.4	-2.5	82.7	21.5	20.8	3.8	-4.6	57.3
Anchor BCI Bond Fund	Feb-16	8.9	48.5	3.1	11.7	0.3	-0.3	47.1	3.6	11.5	1.5	-0.0	1.4
Anchor BCI Diversified Stable Fund	Feb-16	5.8	30.4	2.9	10.7	1.0	-0.7	26.4	3.0	9.4	1.0	-1.0	4.0
Anchor BCI Diversified Moderate Fund	Feb-16	4.3	21.6	0.9	13.8	1.2	-1.2	22.4	2.8	12.6	1.1	-1.5	-0.8
Anchor BCI Diversified Growth Fund	Feb-16	2.8	13.6	-1.0	16.8	1.2	-1.6	19.7	1.8	14.9	1.3	-1.8	-6.0
Anchor BCI Africa Flexible Income	Mar-16	7.4	38.6	4.5	14.9	0.3	-1.7	49.4	8.2	3.6	1.6	0.5	-10.8
Anchor BCI Global Technology Fund	Jun-19	41.6	58.2	56.8	34.6	5.9	-4.2	73.9	59.3	36.8	8.2	-5.1	-15.7
EQUITY NOTES & SEGREGATED MANDATES													
Anchor Equity	Jul-13	5.3	45.5	-8.1	19.9	1.5	1.1	47.0	-5.0	22.9	1.0	-1.1	-1.6
Growing Yield*	Jun-12	3.9	36.9	-27.6	7.1	-3.8	-0.2	119.8	8.1	3.7	3.2	0.6	-82.9
HEDGE FUNDS													
Property Long Short	Jan-14	0.1	0.9	-30.9	5.2	-4.9	-0.3	76.3	7.1	2.7	1.2	0.4	-75.4
Anchor Accelerator	Feb-16	11.5	65.5	23.8	23.6	3.5	-2.6	6.6	-5.0	22.9	1.0	-1.1	58.9
OFFSHORE													
High Street Equity - Dollars	Jun-12	12.1	156.9	15.9	30.6	8.9	-3.7	135.3	11.0	29.2	8.0	-3.4	21.6
High Street Equity - Rands	Jun-12	22.2	424.0	27.5	22.0	4.6	-5.1	379.5	22.1	21.1	3.7	-4.8	44.5
Offshore Balanced - Dollars	Jun-12	9.5	111.3	5.9	18.2	6.3	-2.4	77.2	9.3	19.4	5.9	-2.2	34.1
Offshore Balanced - Rands	Jun-12	19.3	330.3	16.5	10.4	2.0	-3.8	261.6	19.5	12.1	1.8	-3.5	68.7
Global Dividend - Dollars	Jan-14	6.2	49.1	-3.3	12.5	3.7	-2.4	74.9	11.0	29.2	8.0	-3.4	-25.8
Global Dividend - Rands	Jan-14	12.8	123.8	6.4	5.1	-0.5	-3.7	162.4	22.1	21.1	3.7	-4.8	-38.6
Anchor Sanlam Global Stable Fund - Dollars	May-15	1.5	8.5	3.8	7.6	2.4	-0.9	15.4	2.7	1.3	0.6	0.2	-6.9
Anchor Sanlam Global Stable Fund - Rands	May-15	7.7	48.9	14.2	0.9	-1.7	-2.3	59.2	13.6	-4.9	-2.9	-0.9	-10.2
Anchor Sanlam Global Equity - Dollars	May-15	16.4	125.8	74.6	79.1	19.6	-1.0	43.4	10.4	28.9	8.1	-3.2	82.3
Anchor Sanlam Global Equity - Rands	May-15	23.6	210.0	92.0	67.9	14.8	-2.4	96.9	21.5	20.8	3.8	-4.6	113.1

* Provisional figures

DISCLAIMER

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